In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 125

UNITED STATES OF AMERICA, PETITIONER

v.

WILLIAM L. RANDALL, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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BANKRUPTCY DOCKET

73 Cred. Sched. Adjudicated: 11-21-67

NAME OF BANKRUPT/DEBTOR: HALO METAL PRODUCTS, INC.

DIST NO: 0752 | DIV NO: 1 | DOCKET NO: 67 B 6099

an Illinois corporation

CHAPTER OR SECTION: ~~Chapter XI~~

CHECK IF: X Voluntary; Involuntary; Fraud in Inception; X Corporate

DATE PETITION FILED: 8/18/67

DATE CLOSED:

OCCUPATION (Check one): Farmer; Laborer; Professional; Other (Non-business); Merchant; Manufacturer; X Other (Runner)

DISCHARGE: Granted; Denied; Waived or not applied for

DATE DISCHARGED:

ADDRESS OF BANKRUPT/DEBTOR (Number and Street): 750 N~~i~~cholas Blvd.

PETITION DISMISSED: DYES

DATE DISMISSED:

CHAPTER UNDER WHICH CASE WAS FILED OR DISMISSED:

NAME OF JUDGE:

CITY: Elk Grove | ZONE: | COUNTY: Cook | STATE: Ill.

NAME OF REFEREE: MC CORMICK

NO ASSET CASES ONLY — CLAIMS AS SCHEDULED

	TOTAL	PRIORITY	SECURED	UNSECURED
	$	$	$	$

	NAMES AND ADDRESSES
ATTORNEY FOR BANKRUPT OR DEBTOR	Herbert H. Victor 111 W. WashingtinnSt Fi 6-4034
ATTORNEY FOR PETITIONING CREDITORS	
RECEIVER	William L. Randall, 9539 S. Jeffrey Blvd. Ba -1-3300
ATTORNEY FOR RECEIVER	Kevin J. Gillogly & Louis I. Kessler, 10 S. La Salle 100 W. Monroe De 2-0767 Fr 2-4127
TRUSTEE	~~Robert O. Malouch~~, William L. RAndall 9539 S.Jeffrey Blvd. Ba 1-3300
ATTORNEY FOR TRUSTEE	~~Herbert H. Victor 111 W. Washington Fi 6-4034~~ Kevin J. Gillogly, 10 S. La Salle, De 2-0767

CHARGES OF PRINCIPALS

Date	Proceedings
8/18/67	**Enter order, Leave to file corporate Re-organization; Chapter XI with 3 copies of required document, the balance to be filed within 5 days Napoli, Judge** **Notices mailed 8/18/67**
8/18/67	**Voluntary Petition, Schedules, Summary of debts and assets and Statement of Affairs under Chapter XI filed.** **Affidavit G.R. 39 filed.** **Designation filed**
	* * * *
9/11/67	Debtor's weekly report from 8/18/67 to 8/24/67 filed. k
8/24/67	It is ordered that the debtor corporation is authorized to remain in possession of its assets and effects until further order of this court, subject to the court's supervision and control. It is further ORDERED that the debtor shall file each month a report of operations. It is further ORDERED that the debtor shall keep separate books and records of its operations commencing 8/18/67 and continue same til further order of court. It is further ORDERED that the debtor shall maintain 3 separate bank accounts, (see draft for full particulars) It is further ORDERED that the debtor is authorized to retain Robert Halonen at the rate of $200.00 per week. Right is hereby reserved to make such other and further orders as may appear proper in the premises. (dft) (To Ref. McCormick) k

9/11/67 Petition of debtor for entry of an order directing said debtor to continue temporarily in possession and giving directions for the operation of its business, etc., filed. (To Ref. McCormick)

* * * * *

11/22/67 Petition of debtor for adjudication filed. k

11/22/67 It is ordered that Halo Metal Products, Inc., an Illinois Corporation is hereby adjudged a bankrupt under the Bankruptcy Act, as amended. It is further ORDERED that William L. Randall is appointed as Receiver, bond set at $500.00. (dft) k

11/22/67 On the Court's own motion the proceedings under Chapter XI filed herein on Aug. 18, 1967 is hereby dismissed and bankrupt be proceeded with pursuant to the provisions of the Bankruptcy Act. k

11/22/67 Order approving Receiver's bond. (dft) k

11/28/67 Petition of Receiver for leave to employ counsel filed. It is ordered that the Receiver is authorized to employ Kevin J. Gillogly and Louis I. Kessler to represent him; compensation to await further order of Court. (dft) k

11/28/67 Notice filed.

Petition of Receiver for sale of property filed. It is ordered that the Receiver is authorized to employ William T. Sullivan as appraiser; compensation to await further order of court. It is further ORDERED that the Receiver is directed to offer for sale on solicitation of and return of bids all of the assets of the bankrupt

located at 750 Nicholas Drive, Elk Grove Village, Illinois, consisting of chattels customarily and ordinarily used in the processing of metal products, including machinery inventory and office supplies and equipment, all is more particularly set forth in the Receiver's Inventory to be filed herein, bids returnable on Dec. 8, 1967 at 11:00 A.M.; said assets shall be offered for sale first in bulk and piece meal lots at that time to the highest and best bidders for cash; in the event that no satisfactory bids are received the Receiver is authorized to dispose of the assets at public or private sale without further notice to creditors but subject to the further approval of this Court.

It is further ORDERED that all persons having or claiming to have any lines, etc., against any of the assets are directed to show cause and to assert and prove up their interest on Dec. 8, 1967 at 10:30 AM., why the assets should not be sold free and clear of liens, etc.

It is further ORDERED that ten days notice in writing be given to all known creditors of the aforementioned. (dft) k

* * * * *

12/ 8/67 Hearing on lien claimants, if any, to snow cause why assets should not be sold held and adj. sine die.

Hearing on return of bids—sale of assets held and adj. sine die.

ORDERED that the offer of American Auction & Associates, Inc. in the amount of ($1600.00) is hereby approved and William L. Randall, Receiver, be and is hereby authorized and directed to accept said bid, and; That the Re-

ceiver's inventory as filed herein will stand in lieu of a Bill of Sale for the Receiver's right, title and interest to the property listed therein. (dft) a

12/11/67 Notice filed.
Petition of Receiver for rule to show cause filed.
ORDERED that the bankrupt herein, Halo Metal Products, Inc. and Robert G. Halonen appear on January 4, 1968 at 11:00 A.M. and at that time show cause why they or each of them should not be held in contempt of Court for failure to comply with the previous order of this Court, entered August 24, 1967 requiring the filing of written reports while debtor in possession. (dft) a

12/18/67 First meeting of creditors after adjudication held. Bankrupt examined. No creditors present.
Ordered: All claims allowed pro tempore, objections to be filed in 10 days: notice of filing objections to be served on claimant by mail or on local attorney at once: Court appoint: Wm. Randall trustee, bond $1,500.00 (dft)
meeting adjourned. sine die. k

12/20/67 Petition of appraiser for fees filed.
Oath of appraiser filed
It is ordered that the Trustee pay to William T. Sullivan the sum of $35.00 (dft) k

12/20/67 Order Approving Trustee's Bond. (Dft)

* * * * *

12/22/67 Notice filed.
Petition of United States for order allowing a special fund in trust for the petitioner filed. (To Ref. McCormick)
Enter and continue to 1/23/68 at 11.00 A.M. k

12/22/67 Answer of Trustee to petition of U.S. Filed. (To Ref. McCormick) k

12/28/67 Debtor's September report of disbursemen's and receipts filed. k

12/28/67 Debtor's October report of disbursements & receipts filed. k

1/ 2/68 Government's reply to answer of Trustee filed. (To Ref. McCormick) k

1/ 4/68 Hearing on order on bankrupt and Robert G. Halonen to appear and show cause why they should not be held in contempt for failure to file written reports while debtor in possession held.
Hearing adjourned to 1/12/68 at 11:00 A.M.

1/ 4/68 Notice filed. k
Petition of Trustee for leave to employ counsel filed.
It is ordered that the Trustee is authorized to employ Kevin J. Gillogly as his attorney; compensation to await further order of Court. (dft)
k

1/12/68 Adjourned Hearing on Order to appear and show cause why bankrupt and Robert G. Halonen should not be held in contempt of court for failure to comply with order of Aug. 24, 1967 re written reports held.
Hearing adj. to Jan. 19, 1968 at 11:00 a.m.
ht

1/19/68 Adjourned hearing on order on bankrupt and Robert G. Halonen should not be held in contempt for failure to file required written report held.
Hearing adjourned to 2/16/68 at 11:00 A.M.
k

* * * * *

1/23/68 Brief in support of Trustee's reply filed. k

1/23/68 Hearing on petition of U.S. for order allowing a special fund in trust held.
Under advisement. Briefs filed.
Hearing adjourned to 2/20/68 at 11:00 A.M.
k

2/16/68 Adj. hearing on rule to show cause on bankrupt and Robert G. Halonen why they should not be held in contempt for failure to comply with order entered Aug. 24, 1967 held.
Hearing adj. to March 1, 1968 at 11:00 a.m.
ht

2/20/68 Adj. hearing on Petition of United States of America for Order allowing a Special Fund in Trust held.
Hearing adj. to March 5, 1968 at 11:00 a.m.
ht

3/ 1/68 Adjourned hearing on rule on bankrupt and Robert G. Halonen should not be held in contempt for failure to file written reports held.
Hearing adjourned to 3/15/68 at 11:00 A.M.
k

3/ 4/68 Final monthly report of debtor for 1/11/67 through 11/23/67 filed. k

3/ 5/68 Adjourned hearing on petition of U.S. for order allowing a special fund in trust held.
Hearing adjourned sine die.
It is ordered that all funds deposited by the debtor-in-possession for the payment of U.S. taxes be paid to the Internal Revenue Service not to exceed the sum of $1,075.02.
It is further ORDERED that the application for the imposition of a special trust fund on all other assets of the estate in the amount of $1,075.02 is denied. (dft) k

3/ 8/68 Motion of U.S. to extend time to 30 days to file its petition for review filed.
It is ordered that the period for filing a petition for review, on behalf of the U.S.A. pursuant to 11 U.S.C. Sec. 67(c) be extended 30 days to April 5, 1968. (dft) k

3/13/68 Petition of attorney for bankrupt for fees filed. (To Ref. McCormick) k

3/15/68 Motion of Court to set 21a exam of Mr. Halonen for 4/2/68 at 10:00 A.M. k

3/15/68 Adjourned hearing on order on bankrupt and Robert G. Halonen should not be held in contempt for failure to file written reports held. Hearing adjourned to 4/15/68 at 11:00 AM.

4/ 1/68 Notice filed. k
Application of Trustee for surcharge—asking Herbert H. Victor to turn over $300.00 filed. (To Ref. McCormick)
Enter and continue to 4/2/68 at 10:00 AM. k
Leave to file ans. in 10 days, 5 days to reply

4/ 2/68 Hearing on application of Trustee for surcharge—asking Herbert H. Victor to turn over $300.00 held.
Hearing adjourned to 4/29/68 at 11:00 A.M. k

4/ 2/68 21a exam of Mr. Halonen held and adj. to 4/29/68 at 11 A.M. k

4/ 5/68 Petition of U.S. Attorney for review of order dated 3/5/68 filed. k

4/15/68 Adjourned hearing on order on bankrupt and Robert G. Halonen re contempt for failure to file written reports held.
It is ordered that the rule heretofore entered is discharged. (dft) k

4/29/68 Adjourned hearing on application of Trustee for surcharge asking Herbert H. Victor to turn over $300.00 held.
Hearing adjourned to 6/3/68 at 11:00 AM.
k

Leave to file answer in additional 30 days hearing set for 6/3/68 at 11:00 A.M. Ref. McCormick
k

4/29/68 Adjourned 21a exam of Mr. Halonen held.
Exam adjourned to 6/3/68 at 11 A.M. k

5/23/68 Certificate of Charles B. McCormick, Referee in Bankruptcy on petition for review of order entered on March 5, 1968 filed. k

5/23/68 Certificate of Referee McCormick filed on 5/23/68 assigned to Judge Campbell according to the rules. k

5/23/68 Notice mailed pursuant to Rule 26 D of the Bankruptcy Rules. k

5/27/68 Certificate on petition for review is taken by the Court pursuant to Rule 13. Rule on all parties to file their briefs. Parties granted 5-10 and 5 days for briefs in support and in opposition.—Campbell, J.
Mailed notices 5/27/68 k

6/ 3/68 Adjourned 21a exam of Mr. Halonen held.
Exam adjourned to 6/10/68 at 2 P.M. k

6/ 3/68 Notice filed.
Motion filed.
Government granted until 6/30/68 to file their brief pursuant to Rule 26 E—Campbell, J.
Mailed notices 6/3/68 k

6/ 3/68 Answer of bankrupt to petition for surcharge filed. k

6/ 3/68 Adjourned hearing on application of Trustee for surcharge asking Herbert H. Victor to turn over $300.00 held.
Hearing adjourned to 6/10/68 at 2:00 P.M.
k

6/10/68 Adjourned 21a exam of Mr. Halonen held.
Exam adjourned to 6/11/68 at 2 P.M. k

•••

6/11/68 Adjourned 21a exam of Mr. Halonen held.
Exam adjourned to 7/26/68 at 11 AM. k

•••

6/10/68 Adjourned hearing on application of Trustee for surcharge asking Herbert H. Victor to turn over $300.00 held.
Hearing adjourned to 6/11/68 at 2 P.M. k

6/11/68 Adjourned hearing on application of Trustee for surcharge asking Herbert H. Victor to turn over $300.00 held.
Hearing adjourned sine die.
It is ordered that Herbert H. Victor is directed to turn over to the Trustee the sum of $300.00 to be paid in equal amounts, 30 days, 60 days and 90 days from the date of the entry of this order. (dft)

6/28/68 Memorandum in support of the Government's petition for review filed. (To Judge Campbell)
k

7/ 3/68 Filed Trustee's memorandum in response to government's petition for review. (To Judge Campbell) k

7/22/68 Notice filed.
Motion filed.

It is ordered that the United States reply to the Trustee's memorandum of law within 30 days. (DRAFT)—Perry, J.
Mailed notices 7/23/68 k

7/26/68 Adjourned Hearing re 21 A Examination of Mr. Halonen held.
Hearing adjourned to October 9, 1968 at 11:00 A.M. mh

8/22/68 Filed Government's reply to trustee's memorandum of law in response to government's petition for review. (to J. Campbell) v

10/ 9/68 Adjourned 21a exam of Mr. Halonen held.
Exam adjourned to 11/18/68 at 11 A.M. k

12/11/68 Filed memorandum and order.

12/11/68 The order of the referee in bankruptcy here certified for review should be and the same is hereby affirmed.—(DRAFT)—Campbell, J.
Mailed notices 12/13/68 k

2/ 6/69 Filed Notice of Appeal by U.S. Atty. k

2/ 6/69 Mailed copy of notice of appeal to Kevin J. Gillogly and Herbert H. Victor k

* * * * *

2/28/69 Notice filed.
Application of Trustee for rule to show cause why Robert Halonen should not be held in contempt of Court for Diversion of funds while debtor-in-possession under Chapter XI filed.
Enter leave to file. 20 days to answer
Set for hearing on March 28, 1969 at 11 A.M.

2/28/69 Notice filed. k
Application of Trustee for rule to show cause why Herbert Victor should not be held in contempt of Court filed.

Enter leave to file. 20 days to answer
Set for hearing on March 28, 1969 at 11 A.M.
k

3/17/69 Notice filed.
Government's motion to extend time to file and docket record on appeal filed.
Enter order, government's motion to extend time to file and docket record on appeal to May 17, 1969. (DRAFT)—Campbell, J.
Mailed notices 3/17/69 k

3/28/69 Hearing on application of Trustee for rule on Herbert Victor should not be held in contempt held.
Hearing adjourned to 4/18/69 at 11 A.M. k

3/28/69 Hearing on application of Trustee for order on Robert Halonen to show cause why he should not be held in contempt held.
Hearing adjourned to 4/18/69 at 11 A.M. k

3/28/69 Motion of trustee for rule to show cause on Herbert H. Victor and Robert Halonen re hearings on contempt
Order of Court 15 days to answer
Hearing set for 4/18/69 at 11 A.M. without further notice. Ref. McCormick k

4/15/69 Response of bankrupt to application of Trustee filed. (To Ref. McCormick) k

4/18/69 Adjourned hearing on application of Trustee for rule on Herbert Victor why he should not be held in contempt held.
Hearing adjourned to 5/14/69 at 11 A.M. k

4/18/69 Adjourned hearing on application of Trustee for order on Robert Halonen to show cause why he should not be held in contempt held.
Hearing adjourned to 5/14/69 at 11 A.M. k

5/ 5/69 Filed stipulation pursuant to the Rules of the United States Court of Appeals. k

5/ 6/69 Certified and transmitted to U.S.C.A., 7th Circuit, Record on Appeal as requested by appellant. $10.90

5/14/69 Adjourned hearing on application of Trustee for rule on Robert Halonen to show cause why he should not be held in contempt held.
Meeting adjourned to 5/22/69 at 11:00 a.m.
jwh

5/14/68 Adjourned hearing on application of Trustee for rule on Herbert Victor why he should not be held in contempt held.
Hearing adjourned to 5/22/69 at 11:00 a.m.
jwh

5/22/69 Adjourned hearing on application of Trustee for rule on Robert Halonen to show cause why he should not be held in contempt held.
Meeting adjourned to 5/29/69 at 11:00 a.m.
jwh

5/22/69 Adjourned hearing on application of Trustee for rule on Herbert Victor why he should not be held in contempt held.
Hearing adjourned to 5/29/69 at 11:00 a,m,
jwh

5/29/69 Adjourned hearing on application of Trustee for rule on Robert Halonen to show cause why he should not be held in contempt held.

Hearing adjourned to 6/4/69 at 11:00 a.m. ORDERED that Robert G. Halonen is to pay to Trustee the sum of $480.93 on or before 6/3/69. That Robert G. Halonen is to appear 6/3/69 at 11.00 a.m. to show cause why he

should not be held in contempt if payment has not been made. (dft) McCORMICK, R.
jwh

5/29/69 Adjourned hearing on application of Trustee for rule on Herbert Victor why he should not be held in contempt held.
Hearing adjourned to 6/4/69 at 11:00 a.m.
ORDERED application against Herbert Victor to comply with a surcharge order is dismissed.
(dft) McCORMICK, R. jwh

6/ 4/69 Adjourned hearing on application of Trustee for rule on Robert Halonen to show cause why he should not be held in contempt held.
Hearing adjourned to 6/9/69 at 11:00 a.m.
jwh

6/ 4/69 Adjourned hearing on application of Trustee for rule on Herbert Victor why he should not be held in contempt held.
Hearing adjourned sine die. jwh

* * * * *

RELEVANT DOCKET ENTRIES IN THE COURT OF APPEALS

Date	
5/7/69	Filed original record on appeal.
*	* * * * *
12/12/69	Filed opinion by Judge Hastings.
12/12/69	Entered judgment affirming, with costs.
*	* * * * *

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

ORDER
(Filed August 24, 1967)

Upon reading and filing the petition of debtor corporation for relief under Chapter XI of the Bankruptcy Act, and it appearing to the best interest of all parties in interest that debtor be permitted to remain in possession of the assets and effects herein involved, and that debtor's business should be operated and carried on in an ordinary course until further order of this court, on motion of Herbert H. Victor, attorney for debtor, and good cause therefore appearing:

It is ordered:

1. That debtor corporation is authorized to remain in possession of its assets and effects and carry on its business in ordinary course until further order of this court, subject to the court's supervision and control.

2. That debtor corporation shall file each month a report of debtor's operations, which report shall contain a summary of all cash receipts and disbursements and of all obligations incurred, the amount of sales on credit, the amount of any accounts discounted, the amount of any accounts receivable collected, and profit made or loss sustained.

3. That debtor shall keep separate books and records of its operations commencing August 18, 1967, and continue the same until further order of this court.

4. That debtor immediately make arrangements to have its gas, water, electricity, and telephone charges segregated, as nearly as may be, as of date of this order, and to keep the same separate henceforth until otherwise ordered.

5. That debtor in possession immediately open three distinct bank accounts with the Bank of Lincolnwood. The first shall be designated the Halo Metal Products, Inc., Debtor, account, and all income derived by debtor in possession shall be deposited therein. Disbursements therefrom shall be made only upon checks signed by Robert G. Halonen and countersigned by Charles B. McCormick, Referee in Bankruptcy, or such other referee in bankruptcy of this court as may be handling these proceedings. The second bank account shall be designated Halo Metal Products, Inc., Payroll Account, and to such account shall be transferred from time to time, as required, the funds to meet the payroll. Checks against the payroll account may be issued from time to time, to pay salaries, wages, and compensation for services or reimbursement for expense of officers, agents, and employees, signed by Robert G. Halonen and after the payroll, showing all such items to be paid, to whom, and the tax, social security, and other deductions, has been presented to and approved by Charles B. McCormick Referee in Bankruptcy, or such other referee in bankruptcy as may be handling these proceedings. The third account shall be known as the Halo Metal Products, Inc., Tax Account; and to such account shall be transferred at the time of each transfer to the payroll account, by check signed and countersigned in like manner, the amount of tax and social security withholdings indicated by the payroll, and such amount as may be required to keep up the unemployment compensation fund contributions of the debtor. Withdrawals from this latter fund shall be made only for payment of the tax and welfare obligations aforesaid,

as the same become due upon check signed by Robert G. Halonen.

Any funds now held under trust account to pay taxes and welfare obligations as next above indicated shall be transferred to the tax account, to be and become part thereof; and debtor, while in possession and operating the business pursuant to this order, is charged with making all tax and other returns called for by law.

6. That until further order of this court, debtor is authorized to retain and employ as its officers and agents the following: Robert Halonen—$200.00 per week.

Right is hereby reserved to make such other and further orders as may appear proper in the premises.

Dated at Chicago, Illinois this 24th day of August, 1967.

/s/ C. McCormick
Referee in Bankruptcy

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

WEEKLY REPORT
(Filed September 11, 1967)

Date of filing Corporate Arrangement—August 18, 1967.

Report from August 18, 1967 to August 24, 1967.

A. PAYROLL—August 18, 1967 to August 24, 1967:

Name	U.S. Income Tax	Social Sec. Tax	Net Check	Gross Check
1. Theodore E. Wenger	0	$ .72	$ 15.53	$ 16.25
2. Martin John Spak	3.20	1.12	21.06	25.38
3. Heinz Dalibozar	58.10	15.40	276.50	350.00
4. Robert Binning	20.90	8.80	170.30	200.00
Total Payroll Gross				$591.63

Total Net Payroll Checks	$483.39	
Total U.S. Income Tax withheld; deposited in temporary Trust Account	82.20	
Total Social Security Tax deposited in temporary Trust Account	26.04	
Total Disbursement	$591.63	$591.63

B. CURRENT OPERATING EXPENSES FOR PERIOD OF REPORT

1. Monroe International	Rental of Calculator	$ 49
2. Joe Strzelecki	Shop Supplies	11
3. Petty Cash		22
4. John J. Garrity	Accountant	35
5. Lindberg Steel Treating Co.	Heat Treating	23
6. U.S. Steel Supply Co.	Material	228
Total Expenses For Period Of Report		$368

Note: In the absence of Court authority, the corporation functioned with its existing checking account.

C. INCOME RECEIVED FOR PERIOD OF REPORT

1. Ordnance Engineering Asso., Inc.	$212.40
2. Crane Packing Company	578.94
Total Income For Period Of Report	$791.34

CASH RECAPITULATION

A. Total Disbursement for Payroll and withholding for period of report		$591.63
B. Total Expenses for period of report		368.55
C. Total Income for period of report	$791.34	
Deficit of operational expenses for period of report		$168.84

Note: Cor_ tion had cash in its Corporate Checking Account as of August 14, 1967.

ACCOUNTS PAYABLE RECEIVED IN PERIOD OF REPORT AND NOT YET PAID

Krivo Industrial Supply Co.	Shop Supplies	$ 11.42
Krivo Industrial Supply Co.	Shop Supplies	25.53
F. Landon Cartage	Freight	5.00
Lindberg Steel Treating Co.	Heat Treating	5.00
Simplex Time Recorder Co.	Time Cards & Rack	19.20
Supreme Chemical Co., Inc.	Cleaning Supplies	24.67
Supreme Chemical Co., Inc.	Sanitation Service	18.90
U.S. Steel Supply Co.	Material	58.25
U.S. Steel Supply Co.	Material	169.61
Vetcoa Midwest	Shop Supplies	5.20
Total Accounts Payable Received in Period of Report		$342.78

E. WORK IN PROCESS, IN SHOP FOR PERIOD OF REPO

1.	Northern Signal Co.	# 1697	$ 41
2.	Motor Wheel Corporation	# G. P. 20185	17
3.	Motor Wheel Corporation	# G. P. 20183	24
4.	Ordnance Engineering Asso., Inc.	# 10901	7,99
5.	International Harvester Co.	# CE5561-HA-3A	14
6.	International Harvester Co.	# CE44722-HW-3A	17
7.	International Harvester Co.	# CE5929-HD-8X	79
8.	International Harvester Co.	# CE5443-HW-3A	17
9.	International Harvester Co.	# BP-1136 "A"	31
10.	International Harvester Co.	# CE75795-XJ	18
11.	International Harvester Co.	# Job No. 013	20
	Total Work In Process		$10,82

F. ACCOUNTS RECEIVABLE OUTSTANDING AS OF PERIOD OF REPORT

As per Schedule B-3 in petition filed herein	$6,590.68
Total Receivables Outstanding	$6,590.68

GROSS RECAPITULATION

Deficit of operating expense for period of report		$168.84
D. Accounts Payable Received in period of report		342.78
E. Work in Process for period of report	$10,822.00	
F. Accounts Receivable Outstanding for period of report	$ 6,590.68	
	$17,412.68	$511.62
NET OPERATING POSITION OF CORPORATION as of August 24, 1967.	$16,901.06	

Respectfully Submitted
Halo Metal Products, Inc.
By: /s/ Robert G. Halonen
President

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

WEEKLY REPORT
(Filed September 26, 1967)

Date of filing Corporate Arrangement—August 18, 1967.
Report from August 25, 1967 to August 31, 1967:

A. PAYROLL—August 25, 1967 to August 31, 1967:

Name	Income Tax	U.S. Social Sec. Tax	Net Check	Gross Check
1. James B. Binning	$20.50	$10.41	$205.69	$236.60
2. Ed Vogt	18.80	4.93	88.27	112.00
3. Sam Matthews	7.50	5.28	97.22	110.00
4. Theodore E. Wenger	1.10	5.72	123.18	130.00
5. Rick Englebrecht	30.70	10.73	202.32	243.75
6. Martin Spak	8.50	2.46	45.04	56.00
7. Heinz Dalibozar	58.10	15.40	276.50	350.00
8. Sam Matthews	14.10	7.06	139.34	160.50

Total Payable Gross Income $1,398.85

Total Net Payroll Checks $1,177.56

Total U.S. Income Tax withheld; deposited in temporary Trust Account 159.30

COPY BOUND CLOSE IN CENTER

Total Social Security Tax deposited in temporary Trust Account	61.99	
Total Disbursement	$1,398.85	$1,398.85

B. CURRENT OPERATING EXPENSES FOR PERIOD OF REPORT

1. Coca Cola Bottling Co.	Pop Machine	$ 16.3
2. Villa	Shop Supplies	19.0
Total Expenses for Period of Report		$ 35.3

C. INCOME RECEIVED FOR PERIOD OF REPORT

1. U.S. Steel Corporation	8/25/67	$ 69.08
2. International Harvester Co.	8/28/67	113.95
3. Crane Packing Co.	8/28/67	29.75
Total Income For Period Of Report		$212.78

CASH RECAPITULATION

A. Total Disbursement for Payroll and withholding for period of report		$1,398.85
B. Total Expenses for period of report		35.26
C. Total Income for period of report	$212.78	
Deficit of operational expenses for period of report		$1,221.33

Note: Corporation had cash in its Corporate Checking Account as of August 14, 1967.

D. ACCOUNTS PAYABLE RECEIVED IN PERIOD OF REPORT

1.	Kafar Printing	Office Supplies	$ 13.59
2.	Krivo Industrial Supply Co.	Shop Supplies	24.09
3.	Ultra Matic Equipment Co.	Shop Supplies	82.95
4.	J. R. Gottlieb Co.	Water	3.92
		Heat	8.90
	Total Accounts Payable Received in Period of Report		$133.45

E. WORK IN PROCESS, IN SHOP for PERIOD OF REPORT

1.	Northern Signal Co.	# 1697	$ 415.00
2.	Motor Wheel Corporation	GP 20185	176.00
3.	Motor Wheel Corporation	GP 20183	245.00
4.	Ordnance Engineering Asso. Inc.	01901	7,990.00
5.	International Harvester Co.	CE 5561-HA-3A	140.00
6.	International Harvester Co.	CE 4472-HW-3A	178.00
7.	International Harvester Co.	CE 5929-HD-8X	792.00
8.	International Harvester Co.	CE 5443-HW-3A	175.00
9.	International Harvester Co.	BP 1136-"A"	158.00
10.	International Harvester Co.	CE 757957	189.00
11.	International Harvester Co.	CE 75835 XJ	207.00
12.	International Harvester Co.	CE 7667 XJ	235.00
13.	International Harvester Co.	CE 76700XJ	40.00
14.	International Harvester Co.	CE 76699XJ	65.00
15.	International Harvester Co.	CE 76696XJ	135.00
16.	International Harvester Co.	CE 76698XJ	40.00
	Total Work In Process		$11,180.00

COPY BOUND CLOSE IN CENTER

E.' NEW ORDERS

1.	International Harvester Co.	CE 7667XJ	$ 235.00
2.	International Harvester Co.	CE 76700XJ	40.00
3.	International Harvester Co.	CE 76699XJ	65.00
4.	International Harvester Co.	CE 76696XJ	135.00
5.	International Harvester Co.	CE 76698XJ	40.00
	Total New Orders		$ 515.00

F. ACCOUNTS RECEIVABLE OUSTANDING as of PERIOD OF REPORT

1.	International Harvester Co.	8/31/67	157.00
2.	Plus—As per Schedule B-3 in petition		6,590.68
	Total Receivables Outstanding		$6,747.68

GROSS RECAPITULATION

	Deficit of operating expense for period of report		$1,221.33
D.	Accounts Payable Received in Period of Report		133.45
E.	Work in Process for Period of Report	11,180.00	
F.	New Orders	515.00	
G.	Accounts Receivable Outstanding for period of report	6,747.68	
		$18,442.68	$1,354.78

NET OPERATING POSITION OF CORPORATION as of August 31, 1967 $17,087.90

Respectfully Submitted
Halo Metal Products, Inc.
By: /s/ Robert G. Halonen
President

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

WEEKLY REPORT

(Filed September 26, 1967)

Date of filing Corporate Arrangement—August 18, 1967.
Report from September 1, 1967 to September 7, 1967.

A. PAYROLL—September 1, 1967 to September 7, 1967:

Name	U.S. Income Tax	Social Sec. Tax	Net Check	Gross Check
1. Heinz Dalibozar	$58.10	$15.40	$276.50	$350.00
2. Richard Dale Englebrecht	30.70	10.73	202.32	243.75
3. Martin Spak	9.60	2.81	51.47	63.88
4. Theodore E. Wenger	.40	5.51	119.22	125.13

Total Gross Payable $782.76

Total Net Payroll Checks $649.51

Total U. S. Income Tax withheld; deposited in temporary Trust Account 98.80

COPY BOUND CLOSE IN CENTER

Total Social Security Tax deposited in temporary Trust Account	34.45	
Total Disbursement	$782.76	$782.76

B. CURRENT OPERATING EXPENSES FOR PERIOD OF REPORT

1.	Robert K. Binning	June Expenses	15
2.	Chicago Metal Mfg. Co.	Material	10
3.	Driscoll Co.	Plating	1
4.	Steel Sales Corp.	Material	30
	Total Expenses For Period of Report		$58

C. INCOME RECEIVED FOR PERIOD OF REPORT

1.	Crane Packing Co.	9/5/67	123.76
2.	Ordnance Engineering Asso., Inc.	9/6/67	749.10
3.	Steel Sales Corporation	9/6/67	1,064.16
	Total Income For Period Of Report		$1,937.02

CASH RECAPITULATION

A. Total Disbursement for Payroll and withholding for period of report		$782.76
B. Total Expenses for period of report		582.63
C. Total Income for period of report	1,937.02	
Deficit of operational expenses for period of report		$561.33

Note: Corporation had cash in its Corporate Checking Account as of August 14, 1967.

D ACCOUNTS PAYABLE RECIVED IN PERIOD OF REPORT

1.	Aaron Engravers	Shop services	22.50
2.	Adel Electric & Auto Supply Co., Inc.	Shop Services	6.13
3.	Aaron Engravers	Shop Services	45.25
4.	Associated Services	Office Supplies	12.00
5.	J. R. Gottlieb & Co.	Rent	750.00
6.	Illinois Bell Telephone Co.	Telephone Bill	234.84
7.	Lee Supply & Tool Co.	Shop Supplies	16.59
8.	Lindberg Steel Treating Co.	Shop Services	5.00
9.	Lindberg Steel Treating Co.	Shop Services	38.70
10.	United States Steel Supply Corp.	Material	36.26
11.	United States Steel Supply Corp.	Material	30.74
	Total Accounts Payable in Period of Report		$1,198.01

E'. WORK IN PROCESS, IN SHOP for PERIOD OF REPORT

1.	Lift Parts Mfg. Inc.	Job No. 021	299.00
2.	Lift Parts Mfg. Inc.	Job No. 022	55.00
3.	Northern Signal Co.	P.O. # 1697	415.00
4.	Motor Wheel Corp.	P.O. # GP20185	176.00
5.	Motor Wheel Corp.	P.O. # GP20183	245.00
6.	Ordnance Eng. Asso., Inc.	P.O. # 01901	6,741.90
7.	International Harvester Co.	CE 4472-HW-3A	178.00
8.	International Harvester Co.	CE 5929-HD-8X	792.00
9.	International Harvester Co.	BP 1136-"A"	158.00
10.	International Harvester Co.	CE 757957	189.00

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11.	International Harvester Co.	CE 7667XJ	235.00
12.	International Harvester Co.	CE 76700XJ	40.00
13.	International Harvester Co.	CE 76699XJ	65.00
14.	International Harvester Co.	CE 76676 XJ	135.00
15.	International Harvester Co.	CE 76698XJ	40.00
16.	International Harvester Co.	Job No. 019	975.00
17.	International Harvester Co.	Job No. 020	57.50
	Total Work In Process		$11,016.49

E'. NEW ORDERS

1.	Lift Parts Mfg. Co.	Job No. 021 9/7/67	299.00
2.	Lift Parts Mfg. Co.	Job No. 022 9/7/67	55.00
3.	International Harvester Co.	Job No. 019 9/7/67	975.00
4.	International Harvester Co.	Job No. 020 9/7/67	57.50
5.	Signode Corporation		220.00
	Total New Orders		$1,606.50

F. ACCOUNTS RECEIVABLE OUSTANDING as of PERIOD OF REPORT

1.	International Harvester Co.	9/1/67	207.00
2.	International Harvester Co.	9/1/67	266.00
3.	Ordnance Eng. Asso. Inc.	9/7/67	1,407.40
4.	Ordnance Eng. Asso. Inc.	9/7/67	1,066.90
5.	International Harvester Co.	9/7/67	221.62
	Total Receivable Outstanding		$3,168.92

GROSS RECAPITULATION

Deficit of operating expense for period of report		$ 582.63
D. Accounts Payable Received in Period of Report		$1,198.01
E. Work in Process for Period of Report	$10,796.00	
F. New Orders	1,606.50	
G. Accounts Receivable Outstanding for Period of Report	3,168.92	
	15,571.42	1,780.64
NET OPERATING POSITION OF CORPORATION as of September 7, 1967	$13,790.78	

Respectfully Submitted
Halo Metal Products, Inc.
By: /s/ Robert G. Halonen
President

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

WEEKLY REPORT
(Filed September 26, 1967)

Date of filing Corporate Arrangement—August 18, 1967.
Report from September 8, 1967 to September 14, 1967

COPY BOUND CLOSE IN CENTER

A. PAYROLL—September 8, 1967 to September 14, 1967:

Name	U.S. Income Tax	Social Sec. Tax	Net Check	Gross Check
1. Richard Dale Englebrecht	$30.70	$10.73	$202.32	$243.75
2. Martin Spak	10.60	3.06	55.90	69.56
3. Robert K. Binning	30.00	11.00	209.00	250.00
4. Robert G. Halonen	16.40	8.50	174.80	199.70
Total Payroll Gross				$763.01
Total Net Payroll Checks			$642.02	
Total U.S. Income Tax withheld; deposited in temporary Trust Account			87.70	
Total Social Security Tax deposited in temporary Trust Account			33.29	
Total Disbursement			$763.01	$763.01

B. CURRENT OPERATING EXPENSES FOR PERIOD O REPORT

1. Paul A. Kenyon	Salesman Expenses	163
2. Halo Metal Special Account	Tax Escrow	300.0
3. Robert G. Halonen	Expenses	280.9
4. Petty Cash		20.0
Total Expenses For Peeriod Of Report		$617.9

C. INCOME RECEIVED FOR PERIOD OF REPORT

1.	International Harvester Co.	9/13/67	$265.05
2.	International Harvester Co.	9/14/67	156.71
3.	Ordnance Eng. Asso. Inc.	9/14/67	45.40
TOTAL INCOME FOR PERIOD OF REPORT			$467.16

CASH RECAPITULATION

A. Total Disbursement for Payroll and withholding for period of report		$763.01
B. Total Expenses for period of report		617.28
C. Total Income for period of report	$467.16	
DEFICIT of operational expenses for period of report		$913.13

NOTE: Corporation had cash in its Corporate Checking Account as of August 14, 1967.

ACCOUNT PAYABLE RECEIVED IN PERIOD OF REPORT ON

Aaron Engravers	Shop Services	92.00
Acme Inc.	Shop Services	30.00
Adel Electric & Supply Co.	Shop Services	15.43
Commonwealth Edison Co.	Utilities	288.17
Great Lakes Tool Service	Shop Services	18.00
Krivo Industrial Supply Co.	Shop Material	29.56
Lipomi Co.	Shop Services	20.00
Lindberg Steel Treating Co.	Shop Services	39.41

COPY BOUND CLOSE IN CENTER

9.	Magnetic Inspection Laboratory	Shop Services	8
10.	Rainbow Electric Co. Inc.	Shop Services	62
11.	Signode	Shop Supplies	44
12.	United States Steel Supply	Shop Supplies	5
13.	United States Steel Supply	Shop Supplies	58
14.	United States Steel Supply	Shop Supplies	169
15.	Van Der Molen	Disposal Co.	10
	TOTAL ACCOUNTS PAYABLE		$891

Received in Period of Report

E.[1] WORK IN PROCESS, IN SHOP for PERIOD OF REPORT

1.	Addison Pipe & Supply	Job # 026	250
2.	International Harvester Co.	CE 77910 XJ	120
3.	International Harvester Co.	CE77909 XJ	110
4.	International Harvester Co.	CE44722HW3A	178
5.	International Harvester Co.	CE 5929 HD 8X	792
6.	International Harvester Co.	BP 1136"A"	158
7.	International Harvester Co.	CE 75794XJ	189
8.	International Harvester Co.	CE 76697XJ	235
9.	International Harvester Co.	CE6909HD5N	57
10.	International Harvester Co.	Ce 76696 XJ	135
11.	International Harvester Co.	CE 5997 HD 5T	973
12.	Lift Parts Mfg. Inc.	53126	299
13.	Motor Wheel Corp.	GP 20185	176
14.	Motor Wheel Corp.	GP 20183	245
15.	Northern Signal Co.	1697	415
16.	Ordnance Eng. Asso. Inc.	10901	4,098
17.	Signode Corp.	CT 44416	216
18.	Signode Corp.	CT 44636	424
	TOTAL WORK IN PROCESS		$9,667

E. NEW ORDERS

1. Addison Pipe & Supply	Job # 026	$ 250.00
2. International Harvester Co.	CE 77910 Xj	120.00
3. International Harvester Co.	CE 77909 SJ	110.00
4. Signode Corp.	CT 44416	216.00
5. Signode Corp.	CT 44636	424.00
	TOTAL NEW ORDERS	$1,120.00

F. ACCOUNTS RECEIVABLE OUTSTANDING for PERIOD OF REPORT

1.	Lift Parts Mfg. Co.	9/11/67	$ 55.00
2.	International Harvester Co.	9/14/67	40.00
3.	International Harvester Co.	9/14/67	40.00
4.	Ordnance Eng. Asso. Inc.	9/14/67	2,043.00
	TOTAL RECEIVABLES OUTSTANDING		$2,178.00

GROSS RECAPITULATION

DEFICIT of operating expense for period of report		$ 617.28
D. Accounts Payable Received in Period of Report		891.31
E. Work in Process for period of report	$9,667.40	
F. Accounts Receivable Outstanding for period of report	2,178.00	
	11,845.40	1,508.59
NET OPERATING POSITION OF CORPORATION as of September 14, 1967.	$10,336.81	

Respectfully Submitted
HALO METAL PRODUCTS, INC.
BY: /s/ Robert G. Halonen
President

COPY BOUND CLOSE IN CENTER

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

ORDER OF ADJUDICATION
(Filed November 22, 1967)

It appearing that a Chapter XI proceedings was filed herein on August 18, 1967 and the Debtor being unable to carry out the Plan of Arrangement; and

That the Debtor consents to be adjudged a bankrupt on November 21, 1967, now, therefore;

It Is Ordered That Halo Metal Products, Inc., an Illinois Corporation, be and it is hereby adjudged a bankrupt under the Bankruptcy Act, as amended.

It Is Further Ordered and I hereby appoint William L. Randall of Chicago, Illinois as Receiver of the estate of Halo Metal Products, Inc., and fix the amount of his bond at $500 (Five Hundred) Dollars.

/s/ C. B. McCormick
Referee in Bankruptcy

Dated: November 21, 1967

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

PETITION
(Filed December 11, 1967)

To: The Honorable Charles B. McCormick,
Referee in Bankruptcy:

Now comes William L. Randall, Receiver in the aforenamed estate and represents to this Honorable Court as follows:

1. That he is the duly appointed and acting Receiver in the abovenamed estate having qualified by filing his bond as approved by this Honorable Court.

2. That pursuant to his duties as Receiver he checked into the affairs of the bankrupt herein and determined that during the course of time that the bankrupt was operating as a debtor in possession under Chapter XI an order was entered requiring said debtor in possession to file monthly reports with the Court showing receipts and disbursements.

3. That there were some reports that were filed during the period of time from the filing of the Chapter XI petition up through September 14, 1967, but since that date there have been no reports filed.

4. That the debtor in possession is presently delinquent in its obligation to supply the Court with all the information necessary in compliance with the order heretofore entered by this Court on August 24, 1967.

5. That the best interests of the estate require that these reports be made in compliance with said order.

Wherefore, William L. Randall, Receiver herein, prays for an order entered on the bankrupt, Halo Metal Products, Inc., for a rule to show cause why it and its officers should not be held in contempt of this Court for failure to comply with the order and for such other relief as the Court shall deem meet and just.

/s/ William L. Randall
William L. Randall, Receiver

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division
[Caption Omitted]

PETITION
(Filed December 22, 1967)

Now comes Edward V. Hanrahan, United States Attorney for the Northern District of Illinois and states:

1. That the United States has filed claims against this estate for taxes in the total amount of $2,718.95.

2. That of the total amount, the sum of $1,075.02 is for Withholding and Social Security taxes for the third quarter of 1967, a period during which the bankrupt operated as Debtor-in-Possession under the jurisdiction of the court.

3. That by virtue of 26 U.S.C. 7501, a special fund in trust for the benefit of the United States is imposed on the aforementioned $1,075.02 to be paid prior to costs of administration.

Wherefore, it is prayed that this court order the sum of $1,075.02 to be a special fund in trust in favor of the United States to be paid prior to costs of administration.

/s/ Edward V. Hanrahan
Edward V. Hanrahan,
United States Attorney.

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division
[Caption Omitted]

ANSWER
(Filed December 22, 1967)

Now comes William L. Randall, Trustee in Bankruptcy in the aforenamed estate and respectfully represents to this Court as follows:

1. That he is the duly appointed and acting Trustee in Bankruptcy having qualified by filing his bond as approved by this Honorable Court.

2. That he has examined into the affairs of the estate of the bankrupt at the First Meeting of Creditors to determine through Robert G. Halonen the existence of any trust account set up for the purposes of paying taxes pursuant to an order entered under Chapter XI proceedings.

3. That the Trustee was advised upon examination of Mr. Halonen that a trust account was created in the Elk Grove State Bank, Elk Grove Village, Illinois, for the purposes of paying the taxes but that regular deposits were not made as required under order of Court.

4. That the Trustee is holding no funds of the bankrupt under any trust arrangement or agreement for the benefit of the United States of America or any person.

5. That 26 U.S.C. 7501 does not provide for the imposition of a trust on the assets of this bankrupt which has been reduced to cash by sale conducted by the Trustee herein.

Wherefore, William L. Randall, Trustee herein, prays that the petition for the imposition of a trust to the sum of One Thousand, Seventy-Five And No/100 ($1,075.00) Dollars prior to the costs of administration be denied and for such other relief as the Court shall deem meet and just.

/s/ William L. Randall
William L. Randall, Trustee

UNITED STATES DISTRICT COURT
The Northern District Of
Illinois, Eastern Division

[Caption omitted]

SEPTEMBER REPORT
(Filed December 28, 1967)

Date of filing Corporate Arrangement—August 18, 1967.

Report from September 14, 1967 to September 30, 1967.

A. PAYROLL—September 14, 1967 to September 30, 1967:

	NAME	U.S. Income Tax	Social Sec. Tax	Net Check	Gross Check
1.	Heinz Dalibozar	$52.10	$14.40	$260.75	$ 327.25
2.	Rick Engelbrecht	28.70	10.21	193.14	232.05
3.	Robert K. Binning	30.00	11.00	209.00	250.00
4.	Robert G. Halonen	16.70	8.50	174.80	200.00
	TOTAL GROSS PAYABLE				$1,009.30
	TOTAL Net Payroll Checks			$ 837.69	
	TOTAL U.S. Income Tax withheld; deposited in temporary Trust Account			127.50	
	TOTAL Social Security Tax deposited in temporary Trust Account			44.11	
	TOTAL DISBURSEMENT			$1,009.30	$1,009.30

B. OPERATING EXPENSES FOR PERIOD OF REPORT

1.	ADDISON PIPE & SUPPLY CO.	Material	$ 35.58
2.	DRISCOLL AND COMPANY	Shop Services	9.00
3.	GREAT LAKES TOOL SERVICE	Shop Services	18.00
4.	JET FASTENER CORP.	Shop Services	17.82
5.	KNIVES AND SAWS INC.	Shop Supplies	129.15
6.	U.S. STEEL SUPPLY CORP.	Material	139.62
7.	U.S. STEEL SUPPLY CORP.	Material	201.44
8.	U.S. STEEL SUPPLY CORP.	Material	21.80
10.	COCA COLA BOTTLING CO.	Pop Machine	4.50
11.	INTERNATIONAL HARVESTER	Material	74.77
12.	PETTY CASH	Returned Parts	3.30
			52.60
	TOTAL EXPENSES FOR Period of Report		$707.19

INCOME RECEIVED FOR PERIOD OF REPORT

CRANE PACKING CO.	9-16-67	$ 477.02
KOGEN ELECTRIC CO.	9-16-67	20.00
INTERNATIONAL HARVESTER	9-19-67	426.47
ORDNANCE ENGINEERING ASSO.	9-21-67	1,021.50
TOTAL INCOME FOR Period of Report		$1,944.99

CASH RECAPITULATION

A. Total Disbursement for Payroll and withholding for period of report		$1,009.30
B. Total expenses for period of report		707.18
C. Total Income for period of report	$1,944.99	
PROFIT of operational expenses for period of report		$ 228.51

ACCOUNTS PAYABLE received in Period of Report and not yet paid

Krivo Industrial Supply Co.	Shop Supplies	$15.00
Krivo Industrial Supply Co.	Shop Supplies	25.00
F. Landon Cartage	Freight	5.00
Lindberg Steel Treating Co.	Heat Treating	5.00
Supreme Chemical Co., Inc.	Cleaning Supplies	21.00
Supreme Chemical Co., Inc.	Sanitation Service	18.90
U.S. Steel Supply Co.	Material	42.25
Vetcoa Midwest	Shop Supplies	7.10
TOTAL ACCOUNTS PAYABLE Received in Period of Report		$139.25

E. WORK IN PROCESS in shop for Period of Report

NAME	JOB. NO.	AMOUNT
NORTHERN SIGNODE	1697	$ 415.00
INTERNATIONAL HARVESTER	CE44772-HW-3A	178.00
INTERNATIONAL HARVESTER	CE5929-HD-8X	792.00
ORDNANCE ENGINEERING ASSO.	10901	4,698.50
INTERNATIONAL HARVESTER	CE75795-XJ	189.00
INTERNATIONAL HARVESTER	CE76696 XJ	135.00
INTERNATIONAL HARVESTER	CE5997HD-5T	975.00
INTERNATIONAL HARVESTER	CE77909-XJ	110.00
INTERNATIONAL HARVESTER	CE77910-XJ	120.00
	TOTAL WORK IN PROCESS	$7,612.50

F. ACCOUNTS RECEIVABLE Outstanding for Period of Report

NAME	DATE	AMOUNT
INTERNATIONAL HARVESTER	9-18-67	$ 65.00
INTERNATIONAL HARVESTER	9-18-67	59.50
SIGNODE CORP.	9-18-67	216.00
MOTOR WHEEL CORP.	9-18-67	267.50
KOGEN ELECTRIC CO.	9-16-67	20.00
ADDISON PIPE & SUPPLY CO.	9-20-67	168.50
INTERNATIONAL HARVESTER	9-20-67	235.00
LIFT PARTS MFG. CO.	9-20-67	6.50
MOTOR WHEEL CORP.	9-21-67	242.00
INTERNATIONAL HARVESTER	9-15-67	133.50
	TOTAL RECEIVABLE OUTSTANDING	$1,445.75

G. NEW ORDERS for period of report

NAME	JOB NO.	AMOUNT
MAREMONT CORP.	68976	$325.00
INTERNATIONAL HARVESTER	CE79057-XJ	150.00
INTERNATIONAL HARVESTER	CE79082-XJ	120.00
REFLECTOR HARDWARE	0009663	131.25
TOTAL NEW ORDERS for period of report		$726.25

GROSS RECAPITULATION

PROFIT of operating expenses for period of report	$228.51	
D. Accounts Payable received for period of report		139.25
E. Work In Process for period of report	7,612.90	
E. Accounts Receivable Outstanding for period of report	1,445.78	
G. NEW ORDERS for period of report	$ 726.25	
	$10,013.44	$139.25
OPERATING POSITION OF CORPORATION as of September 30, 1967.	$9,874.19	

Respectfully Submitted

HALO METAL PRODUCTS, INC.
BY: /s/ Robert G. Halonen
President

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

ORDER
(Filed March 5, 1968)

At Chicago, Illinois, in said Division and District aforesaid before the Honorable Charles B. McCormick, Referee in Bankruptcy, this 5th day of March, A.D., 1968:

This matter coming on to be heard on the petition of Edward V. Hanrahan, United States Attorney, for the reclamation of $1,075.02 as a special trust fund arising out of the debtor in possession during the Chapter XI proceedings and upon the answer of William L. Randall, Trustee; the Court having jurisdiction of the parties and the subject matter and being fully advised in the premises as enunciated in the supporting briefs filed herein by both parties;

It Is Hereby Ordered, Adjudged And Decreed as follows:

1. That all funds deposited by the debtor-in-possession for the payment of U.S. taxes be paid to the Internal Revenue Service not to exceed the sum of $1,075.02.

2. That the application for the imposition of a special trust fund on all other assets of the estate in the amount of $1,075.02, is denied.

Enter:
/s/ C. McCormick
Referee in Bankruptcy
[Caption Omitted]

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

PETITION FOR REVIEW
(Filed April 5, 1968)

To The Honorable Judges Of The
United States District Court
For The Northern District Of Illinois:

Now comes Thomas A. Foran, United States Attorney for the Northern District of Illinois, and represents:

1. Petitioner is aggrieved by the order herein entered by the Honorable Charles B. McCormick, Referee in Bankruptcy, on March 5, 1968; a copy of which order is attached hereto and marked Exhibit "A".

2. On March 8, 1968, the Honorable Charles B. McCormick, Referee in Bankruptcy, extended the time in which the United States may file a petition to review the order of March 5, 1968, to and including April 5, 1968.

3. The Referee erred in that the conclusion of law is contrary to law.

4. Presented herewith is a copy of the Government's Memorandum of Law, and a copy of Trustee's Memorandum of Law marked Exhibit "B" and Exhibit "C", respectively.

5. A brief in support of the petition for review will be filed with the Referee within ten days after the Referee's Certificate is filed, as provided by the local rules.

Wherefore, the United States of America prays that said order be reviewed by a judge of this court in accordance with the provisions of the Bankruptcy Act; that the order be reversed and that this court enter an order imposing a special fund in trust on the assets of the estate in the amount of $1,075.02 for the benefit of the United States of America.

/s/ Thomas A. Foran
Thomas A. Foran,
United States Attorney.
Room 1500-South, Federal Bldg.
219 South Dearborn Street
Chicago, Illinois 60604
353-5358

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

CERTIFICATE ON PETITION FOR REVIEW
(Filed May 23, 1968)

To The Honorable Chief Judge Campbell
Judge Of The United States District Court,
For The Northern District Of Illinois,
Eastern Division, In Bankruptcy Sitting:

Honorable Sir:

I, Charles B. McCormick, Referee in Bankruptcy, herein, on petition to review an order dated March 5, 1968 do hereby certify and transmit herewith the following:

TRANSMITTED HEREWITH

1. Petition of U. S. District Attorney.
2. Trustee's Answer to Government's Petition.
3. Government's Brief in Reply to Trustee's Answer.
4. Trustee's Brief in Support of Trustee's Answer.
5. Order of March 5, 1968 Denying Government's Petition For a Special Trust Fund.
6. Order of March 8, 1968 Extending Time for Government to File its Petition for Review.
7. Government's Petition For Review.

Neither a transcript of the record nor a summary thereof was provided by the petitioner and its appears that such is not necessary to the determination of this review.

STATEMENT OF FACTS

On August 18, 1967 the present bankrupt filed a petition for relief as debtor in possession under Chapter XI of the Bankruptcy Act. On August 24, 1967 orders were entered allowing the debtor to remain in possession and requiring that it file monthly reports, keep separate books and records of its operation as of August 18, 1967 and that it set up separate bank accounts so as to make proper provision for general, payroll and tax matters. The debtor conducted the business until November 22, 1967 at which time it was adjudged a bankrupt.

During the foregoing period of operation the debtor failed to file regular monthly reports and failed to properly set up the bank accounts as ordered with the result that the sum of $1,075.02 claimed by the government to be due for accrued withholding taxes was not deposited in the tax account. What happened to this sum does not appear of record and the consideration of that question is not pertinent to the issues of this review.

Pursuant to order of court the bankrupt's physical assets were sold and the price realized from the sale exceeded by very little the amount of the government's tax claim. The government now seeks to subject these funds to a special trust. It appears that the money realized from the trustee's sale will be the only substantial asset of the estate so that if the government's trust fund theory is upheld there will not be sufficient funds remaining in the estate to meet administrative expenses.

ISSUES TO BE DETERMINED

1. Whether the government is entitled to impress a special trust fund per Section 7501(A) of the Internal Revenue Code for withholding taxes due and owing from a debtor in possession as upon the proceeds realized from trustee's sale of the debtor's (later bankrupt's) physical assets where the debtor, during its period of operation, failed to make proper reserve deposits to secure the government's tax claims.

2. Whether a special trust fund as above detailed can be impressed where the result would be to so deplete the bankrupt estate that expenses of administration cannot be satisfied.

3. Whether the special trust fund detailed by Section 7501(A) of the Internal Revenue Code is entitled to priority over the provisions of Section 64(a) of the Bankruptcy Act which places priority on the payment of all expenses of administration before consideration can be given to tax claims.

THE REFEREE FOUND THAT:

1. In that the debtor failed to set aside the funds representing withholding taxes deducted from employee's wages the government is unable to directly trace the funds upon which it seeks to impress a trust and therefore its petition should be denied. In Hamilton Steel Products, Inc., (64 B. 10712) cited by the government on page 7 of its "Reply to Answer" the tax funds were properly deposited, estate assets were sufficient to meet expenses and there was no contest on the government's application, the order being entered by agreement.

2. The authorities and language set forth in the trustee's "Brief in Support of Trustee's Answer," are deter-

minative of the issue of priority herein and for this reason the government's Petition should be denied.

The issues on review are certified to Your Honor for an opinion thereon.

HEARING ON THIS CERTIFICATE

This certificate to be set down for hearing on Your Honor's Motion calendar.

Respectfully submitted,
/s/ Charles B. McCormick
Referee in Bankruptcy

Dated: May 23, 1968

[Distribution Omitted]

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

MEMORANDUM AND ORDER
(Filed December 11, 1968)

This matter comes before the court on the petition of the government to review the decision of the Referee in Bankruptcy refusing to declare certain funds of the bankrupt a trust for the United States. The funds in question are withholding taxes withheld from wages of the employees of the debtor, but not paid over to the United States.

In its petition for review the government argues that under §7501(a) of the Internal Revenue Code (26 U.S.C. §7501(a)) when one is required to collect taxes from another and to subsequently pay the taxes collected to the government, those monies collected constitute a trust for the benefit of the United States. The Referee found that all priorities in bankruptcy matters should be determined pursuant to §64(a) of the Bankruptcy Act (11 U.S.C. §104) and that the trust fund concept of §7501(a) should not be interpreted to change the scheme of priorities in the Bankruptcy Act. The government's position is supported by a number of court decisions. (City of New York v. Rassner, 2nd Cir., 127 F.2d 703 (1942); United States v. Sampsell, 9th Cir., 193 F.2d 154 (1951); In re Airline-Arista Printing Corp. (S.D.N.Y., 1957) 156 F.Supp. 403.) These decisions, however, have been criticized by a number of more recent authorities. (United States v. Kalishman, 8th Cir., 346 F.2d 514 (1965); In re Connecticut Motor Lines, Inc., 3rd Cir., 336 F.2d 96 (1964); 3A Collier on Bankruptcy §64.02, n27 at p.2070; See also Nicholas v. United States, 384 U.S. 678 (1966)) They have also been expressly and unequivocally rejected

by a recent District Court opinion. (In re Green (D.C., Col, 1967) 264 F.Supp. 849)

For the reasons set forth in these more recent authorities, I find that the order of the referee in bankruptcy here certified for review should be and the same is hereby affirmed.

Enter:

/s/ Campbell
Chief Judge

Dated: December 11, 1968

UNITED STATES DISTRICT COURT
The Northern District of
Illinois, Eastern Division

[Caption Omitted]

NOTICE OF APPEAL
(Filed February 6, 1969)

Notice is hereby given that the United States of America, by Thomas A. Foran, United States Attorney for the Northern District of Illinois, hereby appeals to the United States Court of Appeals for the Seventh Circuit from the order affirming the order of the referee in bankruptcy certified for review, entered in this action on December 11, 1968.

/s/ Thomas A. Foran
Thomas A. Foran
United States Attorney
219 South Dearborn Street
Chicago, Illinois 60604
353-5341

Date: February 6, 1969

[Distribution Omitted]

United States Court of Appeals

FOR THE SEVENTH CIRCUIT

[Caption Omitted]

DECEMBER 12, 1969

Before HASTINGS and KNOCH, *Senior Circuit Judges*, and DILLIN, *District Judge*.*

HASTINGS, *Senior Circuit Judge*. The district court affirmed an order of the referee in bankruptcy refusing to declare a trust in favor of the United States for income and social security taxes withheld from employees' wages by the bankrupt while acting as a debtor-in-possession under an arrangement proceeding pursuant to Chapter XI of the Bankruptcy Act, 11 U.S.C.A. § 701, *et seq.* The United States appealed. We affirm.

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*Judge Dillin is sitting by designation from the Southern District of Indiana.

Halo Metal Products, Inc., filed a petition for an arrangement under Chapter XI on August 18, 1967. On August 20, 1967, orders were entered allowing the debtor to remain in possession and requiring it to file monthly reports, to keep separate books and records of its operation as of August 18, 1967, to set up separate bank accounts for its general, payroll, and tax indebtedness, and to make appropriate disbursements therefrom.

While operating its business as a debtor-in-possession, Halo failed to file regular reports, failed to properly set up the separate bank accounts, failed to deposit in the tax account amounts withheld from employee wages as income and social security taxes, and failed to make payment of such taxes.

On November 22, 1967, Halo was adjudged a bankrupt. Pursuant to court order, its physical assets were sold.

The United States filed a petition in the bankruptcy proceeding for an order imposing a trust in its favor on $1,075.02 of the bankrupt's estate and ordering payment to it of such amount prior to payment of the costs of administration. This amount represents the income and social security taxes withheld by the debtor-in-possession which were not paid over to the United States.

The United States contends such a trust is imposed by Section 7501(a) of the Internal Revenue Code of 1954, which provides:

> "*General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose."

It is well settled that, absent such a trust, taxes incurred during a Chapter XI arrangement enjoy only a *pro rata* first priority with all other administrative expenses under Section 64a(1) of the Bankruptcy Act, 11 U.S.C.A. § 10

(a)(1).[1] *See, e.g., Missouri* v. *Earhart*, 8 Cir., 111 F. 2d 992, 995 (1940) and cases cited therein.

The fund created by the sale of the bankrupt's physical assets is the only substantial asset of the estate and exceeds the Government's tax claim by a mere few hundred dollars. It is thus clear that if the Government is given a super priority under its trust fund theory, the claims for other administrative expenses will not be paid.

Three federal courts of appeal have accepted the Government's trust fund theory in cases presenting factual situations essentially identical to that before us.

The Second Circuit's decision in *City of New York* v. *Rassner*, 2 Cir., 127 F. 2d 703 (1942), is the first, and still leading, case supporting the Government's position. It involved city sales taxes and a state statute making sellers trustees of such taxes for the city upon their collection. The court noted that a beneficiary must trace funds where mingling takes place prior to bankruptcy, but held tracing was unnecessary where a debtor-in-possession acting as an officer of the bankruptcy court mingled trust funds. The court reasoned that "if we hold that the city must now trace the funds, we state in effect that any beneficiary of a trust which is handled by an officer of a bankruptcy court must always protect himself by petitioning in advance for proper administration of the trust. Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it. As a court of equity, a bankruptcy court can hardly proceed on this assumption. It is the duty of the bankruptcy court in distributing an estate to do so equitably." 127 F. 2d at 706. (Footnote omitted.)

The court there recognized that "of course, an overriding policy of the Bankruptcy Act could prevent pre-

[1] "§ 104. Debts which have priority

"(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration * * *. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding * * * shall have priority in advance of payment of the unpaid costs and expenses of administration * * * incurred in the superseded proceeding. * * *"

ferred satisfaction of even trust claims." *Id.* However, it concluded that no such policy was reflected by "the generalities of § 64, subd. a(1)." *Id.*, at 707.

Rassner was followed by the Ninth Circuit in *United States* v. *Sampsell*, 9 Cir., 193 F. 2d 154 (1951), and by the Sixth Circuit in *Hercules Service Parts Corp.* v. *United States*, 6 Cir. 202 F. 2d 938 (1953). Both cases involved federal income and social security withholding taxes and the predecessor statute to Section 7501(a).

The Second Circuit reaffirmed *Rassner* and applied it to federal taxes in In re Airline-Arista Printing Corp., 156 F. Supp. 403 (S.D.N.Y. 1957) aff'd per curiam, 267 F. 2d 333 (1959). It held that the 1952 amendment to Section 64a(1)[2] granting priority to costs and expenses of an ensuing bankruptcy proceeding over costs and expenses of a superseded arrangement did not reflect a new "overriding policy of the Bankruptcy Act" which would compel a reversal of the *Rassner* rule.

With deference and for reasons hereinafter set out, we are unable to follow the *Rassner* line of decisions. We hold that the United States is not entitled to a super priority by virtue of Section 7501(a) of the Internal Revenue Code.

The Third Circuit has noted that the tax trust fund created by the first sentence of Section 7501(a) is limited by the second sentence of that section. "Thus, though such collections are considered by law to be held in trust, that trust is subject to the same limitations as are the taxes from which the trust arose. Here, that limitation is the structure of the Bankruptcy Act * * *." *In re Connecticut Motor Lines, Inc.*, 3 Cir., 336 F.2d 96, 107-08 (1964).[3]

The Supreme Court, since the *Rassner* precedent, has recognized that the second sentence of Section 7501(a)

[2] See footnote 1, *supra*. The second quoted sentence was added by the 1952 amendment. 66 Stat. 426.

[3] The central issue decided in *Connecticut Motor Lines* was that income and social security withholding taxes arising from wages earned prior to bankruptcy, but paid during bankruptcy, were not first priority "costs and expenses of administration" within Section 64a(1), but were fourth priority "taxes legally due and owing by the bankrupt" within Section 64a(4). The quoted passage came in response to the Government's argument that because the taxes were a trust fund, the Government need not file a proof of claim as required in fourth priority matters.

may impose bankruptcy-created limitations on the tax trust fund imposed by the first sentence. In *Nicholas* v. *United States,* 384 U.S. 678 (1966), the Court held that the United States was not entitled to post-bankruptcy *interest* on withholding taxes which accrued while the debtor was in possession under Chapter XI, but which were not paid until after the adjudication of bankruptcy. The Court then continued:

> "We find no merit in the Government's alternative suggestion that the interest on two of the taxes here in question—those withheld from the wages of employees and those collected from the patrons of the cabaret—constitutes a trust fund over which the United States has an absolute priority under §7501(a) of the Internal Revenue Code. • • • The second sentence of § 7501(a) specifically provides that interest on such a trust fund is collectible in the same manner as the taxes from which the fund arose. Since we have already determined that no interest on any of the taxes here in question accrues beyond the period of the arrangement proceeding, no interest could accumulate on a trust fund composed of the withholding and cabaret taxes." 384 U.S. at 690-91. (Footnotes omitted.)

The District Court of Colorado has applied this reasoning to the identical issue before us. It held "the second sentence of § 7501(a) means that the trust fund mentioned in the first sentence is nevertheless subject to the provisions of § 64(a) of the Bankruptcy Act which establishes a priority for all expenses of administration, including taxes. So construed there is no conflict between §7501(a) and §64(a) • • •." *In Re Green,* 264 F. Supp. 849, 851 (1967).

We are persuaded that this construction is correct. It gives effect to both Congressional enactments. On the one hand, it preserves the tax trust arrangement and thus leaves available to the Government certain favorable collection procedures. The legislative history of Section 7501(a) confirms this was the major goal of its enactment. The Senate Committee Report, S. Rep. No. 558, 73d Cong., 2d Sess., p. 53, noted:

> "Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distraint. Section [7501(a)] * * * impresses the amount of taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes."

The Conference Report, H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 32, reflected the same purpose:

> "This amendment impresses taxes collected or withheld with a trust in favor of the United States and makes applicable for the enforcement of the Government's claim the administrative provisions applying to the assessment, collection, and payment of taxes."

On the other hand, this construction makes collection of the trust fund in bankruptcy situations subject to the usual bankruptcy priority rules and thus honors the policy decision of Congress reflected in Section 64 as to the relative merit of various claims upon the bankrupt estate.

But, even if we accept *arguendo* the Government's position that Section 7501(a) is intended to grant trust fund taxes a higher priority in bankruptcy than they are allowed by Section 64a(1) of the Bankruptcy Act, it avails the Government nothing. The Supreme Court has held on a number of occasions that where there is a conflict between the order of priorities set out in the Bankruptcy Act and preferences given to the Government by non-bankruptcy legislation, the bankruptcy priorities should control. *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U.S. 152 (1912); *Davis* v. *Pringle*, 268 U.S. 315 (1925) *Missouri* v. *Ross*, 299 U.S. 72, 76 (1936).[4]

[4] The fact that in both *Guarantee Title* and *Pringle* the Court seems in part to base its decisions on the fact that the bankruptcy priority provision was enacted after the tax preference provision and changed the previous priority scheme in no way detracts from their precedential value for the instant case. Section 7501(a) is derived unchanged from an Act of May 10, 1934, c. 277, § 607, 48 Stat. 708. Present Section 64a(1) derives from the 1938 Chandler Act and represents a clear departure from pre-Chandler Act practice in reducing all costs of administration — including taxes — to a parity in the priority scheme. *See United States* v. *Kalishman*, 8 Cir., 346 F. 2d 514, 517 (1965), and 3A Collier on Bankruptcy 2051-52.

See also United States v. *Key*, 7 Cir., 407 F. 2d 635, 638 (1969) and *United States* v. *Kalishman*, 8 Cir., 346 F.2d 514, 517 (1965).

As above noted, *Nicholas, supra,* held that bankruptcy law overrides the Section 7501(a) trust fund as to the *interest* on withholding taxes attributable to pre-bankruptcy operations by a Chapter XI debtor-in-possession. The Court expressly did not reach the question now before us concerning the *principal* of such taxes. However, its use of the following language indicates the relevance of *Guarantee Title* to that question:

> "We need not here determine whether, with regard to the *principal* of those taxes, the general language of § 7501(a) overrides the strong policy of § 64a(1) of the Bankruptcy Act, which establishes a sharply defined priority that places all expenses of administration on a parity, including claims for taxes. Cf. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U.S. 152; *Davis* v. *Pringle*, 268 U.S. 315; *Missouri* v. *Ross*, 299 U.S. 72."[5] 384 U.S. at 691.

Our reading of *Nicholas* affords no support for the *Rassner* conclusion that there exists no strong bankruptcy policy to override the preference the Government finds created by Section 7501(a). *See also United States* v. *Kalishman, supra* at 520; *In re Connecticut Motor Lines, Inc., supra* at 107-08; and 3A Collier on Bankruptcy 2070, n. 27.

We find such a strong policy in the very enactment of Section 64a(1). In enacting that subsection, Congress clearly rejected earlier priority schemes giving some administrative expenses higher priorities than others and

[5] It should be noted that the Court may have implicitly decided the reserved issue in an earlier portion of its opinion when it said: "[T]axes incurred during the arrangement period are * * * technically a part of the first priority under § 64a(1). The final sentence of that section, however, subordinates arrangement expenses within that priority to the expenses of the superseding bankruptcy administration. Tax claims incurred during Chapter XI proceedings are therefore in fact junior to claims for expenses incurred in subsequent bankruptcy proceedings." 384 U.S. at 687-88. Under the Government's theory the arrangement tax claims take priority over *all* claims for administrative expenses arising out of the bankruptcy proceeding. The Second Circuit specifically so held in *Airline-Arista*, 267 F. 2d at 334, in affirming on the opinion of the learned District Judge, 156 F. Supp. at 407.

provided that all such claims should share equally on a first priority basis. The statute gives no hint of any Congressional intent to continue the more favorable treatment of certain administrative expenses. *See* 3A Collier on Bankruptcy 2070 n. 27 at 2071.

Further indication of an overriding bankruptcy policy against the trust fund preference sought by the Government may be gained from a study of two parallel lines of statutory development, one continually reducing and limiting the priority to be accorded taxes and the other regularly according a more and more favorable priority to administrative expenses. *See In Re Connecticut Motor Lines, supra* at 102-03, and 3A Collier on Bankruptcy 2046-109 and 2149-59. It is clear that if the trust fund theory is accepted, taxes will be paid at the expense of administrative costs. Such a result would be patently contrary to the strong and continuing Congressional policy evidenced by these statutory developments.

Until 1926 "taxes legally due and owing" were given first priority status above all else. *See* 3A Collier on Bankruptcy 2046-48 and 2155-56, and Bankruptcy Acts of 1800, 1841, 1867 and 1898. In that year, taxes were reduced to sixth priority behind, among other things, administrative expenses. Act of May 27, 1926, 44 Stat. 662. This priority was retained in the Chandler Act of 1938.[8] Act of June 22, 1938, 52 Stat. 883. However, that Act further reduced the preference accorded tax claims by making them subject for the first time to the general limitation period for filing claims. 11 U.S.C.A. § 93(n).[9]

On the basis of these amendments, the Supreme Court further reduced the special treatment given taxes by holding they were no longer entitled to a special exemption from the general prohibition against post-bankruptcy in-

[8] Consolidation of some prior categories, however, resulted in taxes being numbered as the fourth priority in the 1938 Act.

[9] "§ 93 Proof and allowance of claims

* * *

"(n) Except as otherwise provided in this title, all claims provable under this title, *including all claims of the United States and of any State or any subdivision thereof*, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed * * *." (Emphasis added.)

terest on claims against the estate. *City of New York* v. *Saper*, 336 U.S. 328 (1949).

The legislative assault continued with a 1966 amendment to Section 64a(4), 11 U.S.C.A. § 104(a)(4), which limited the fourth priority to "taxes • • • legally due and owing • • • *which are not released by a discharge in bankruptcy* • • •." Act of July 5, 1966, 80 Stat. 271 (Emphasis added.) The same legislation amended Section 17a(1), 11 U.S.C.A. § 35(a)(1), to make non-dischargeable only those taxes which became due and owing within three years prior to bankruptcy with certain exceptions.[8] The explanation of these amendments given in the House Report is particularly illustrative of the growing Congressional disfavor with the preferred treatment given tax claims under the Bankruptcy Act. Excerpts are set out in the margin.[9]

---

[8] "§ 35. Debts not affected by a discharge

"(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy [with certain exceptions]."

One of the exceptions covers taxes "collected or withheld from others • • • but not paid over." This is an exception from a limitation on claims for pre-bankruptcy taxes which the Government must be able to trace in order to recover. However, we cannot find in this any support for the Government's position as to post-bankruptcy taxes which it seeks to recover not as taxes but as an administrative expense and which it is unable to trace into any property remaining in the bankrupt's estate.

[9] "[T]here is no time limit under present law on the priority accorded taxes.

"The result has frequently been that tax collectors, assured of a prior claim on the assets of a failing debtor and assured of the nondischargeability of uncollectible tax claims, have allowed taxes to accumulate and remain upaid for long periods of time. With the proliferation of new taxes and the increased rates of old taxes, often little or nothing is left for distribution to general creditors who provided goods and services to the bankrupt.

"The committee has received hundreds of letters from business firms all over the country complaining about this situation. Although a creditor can protect himself to some degree by requiring periodic financial statements from the bankrupt, there are cases in which the true extent of tax liability may not be known, even to the debtor, as where there are unsettled accounting or legal questions. Nor is a creditor protected from a dishonest debtor who issues a false statement of his tax liability. While this may result in barring the debtor's discharge, the Government still has a tax priority which may be large enough to preclude the creditor's participation

In sharp contrast to this continual downgrading of tax claims has been the equally pronounced trend toward insuring the payment of administrative expenses.

Until 1926 claims for administrative expenses had been subordinate to tax claims. *See* 3A Collier on Bankruptcy 2046-48 and 2155-56, and Bankruptcy Acts of 1800, 1841, 1867 and 1898. In that year, they were placed ahead of taxes in the priority scheme. Act of May 27, 1926, 44 Stat. 662. However, the trustee's "costs and administrative expenses" were still subordinate to claims of the referee and of creditors for costs of preserving or recovering assets. *See* 3A Collier on Bankruptcy 2051-52. The 1938 Act included "costs and expenses of administration" in the first category of priorities so that they would have a *pro rata* first priority claim to the estate along with the two items that had preceded them prior to 1938. Act of June 22, 1938, 52 Stat. 883. In 1952 the Act was amended to give priority to administrative expenses of an ensuing bankruptcy proceeding over unpaid administrative expenses of a superseded proceeding. Act of July 7, 1952, 66 Stat. 426. This amendment clearly illustrates Congressional reasoning in preferring administrative expenses to all others. As stated in the Senate Report:

> "Unless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceeding, ahead of all prior incurrred and unpaid administration costs and expenses, there is always danger of a breakdown of administration. There should be assurance to the trustee in the ensuing proceeding that the costs and expenses incurred by him, such as bond premiums, insurance premiums, costs of conducting a public sale and compensation for his services and for the services of his attorney, will be

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* (Continued)

in the distribution of the debtor's assets. *Ultimately, however, the issue would appear to resolve into whether the Government as a creditor should bear part of the economic burden of business failures through the loss of some of its tax claims* which it has allowed to accumulate over a long period of years.

* * *

"The unlimited priority now enjoyed by taxes in bankruptcy proceedings in the United States is inconsistent with the practice in most commercial countries." H.R. Rep. No. 687, 89th Cong., 1st Sess. (1965). (Emphasis added.)

paid out of the assets liquida ted and administered by him ahead of the prior unpai d costs and expenses." Sen. Rep. No. 1395 on S. 2234, 82d Cong., 2d Sess., p. 4 (1952).

These statutory developments ind dicate both a growing recognition in the Congress of the inequity of extending to the Government extraordinary p preferences over other creditors when a taxpayer-debtor experiences financial failure and also a growing realiza tion of the fact that sound bankruptcy administration fo r the benefit of cred itors and Government alike depend s upon insuring pay ment of the expenses necessarily in curred in such admin istration.

The Section 7501(a) trust fund t heory advanced by the Government would subvert both of these strong bank ruptcy policies. For that reason, we hold that even if Section 7501(a) is construed to create the super priority urged by the Government, it is overridden by the strong policies evidenced in Section 64(a) of the Bankruptcy Act.

In sum, we hold that when Section 7501(a) of the In ternal Revenue Code and Section 64a(1) of the Bank ruptcy Act are construed in light of the underlying poli cies, they do not conflict. The trust fund created by the former statute is, by the terms of that statute, subject to the limitations imposed by the l atter statute. Further, we hold that even if we accept the Government's theory that Section 7501(a) creates a pre ference for post-bank ruptcy tax claims higher than th at accorded them by Section 64a(1), that preference is ov erridden by the strong bankruptcy policies reflected in S ection 64 and in the legislative development of that statu te to its present form. We find such a result consistent v ith the treatment by the Supreme Court of analogous q uestions in such cases as *Guarantee Title*, *Pringle*, *Ross* a nd *Nicholas*.

For the foregoing reasons, the m emorandum order of the district court appealed from he rein is affirmed.

AFFIRMED.

A true Copy:
Teste:

.....
Clerk of the U.....
Appeals for ited States Court of
he Seventh Circuit.

United States Court of Appeals

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

Friday, December 12, 1969

[Caption omitted]

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the memorandum order of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this day.

Supreme Court of the United States

No. —

October Term, 1969

[Caption Omitted]

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including April 11, 1970.

(S) THURGOOD MARSHALL,
Associate Justice of the Supreme Court of the United States.

Dated this 4th day of March, 1970.

Supreme Court of the United States

No. 125

October Term, 1970

[Caption Omitted]

Filed October 12, 1970

ORDER ALLOWING CERTIORARI

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted.

○

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United States v. *Sampsell*, 193 F. 2d 154	3

Statutes:

Bankruptcy Act, c. 541, 30 Stat. 544, Sec. 64a, as amended, 11 U.S.C. 104	2, 26–28
Internal Revenue Code of 1954, 26 U.S.C. 7501	2, 3, 6, 29
28 U.S.C. § 960	2, 4, 28–29

Miscellaneous:

Bogert, *Trusts and Trustees* (2d ed., 1962), Sec. 922	6
9 Collier, *Bankruptcy* (14th ed., 1969), par. 10.10, p. 510	4

381-723—70——1

In the Supreme Court of the United States

OCTOBER TERM, 1969

No.

UNITED STATES OF AMERICA, PETITIONER

v.

WILLIAM L. RANDALL, TRUSTEE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The memorandum and order of the district court (Appendix C, *infra*, pp. 24–25) is not officially reported. The opinion of the court of appeals (Appendix A, *infra*, pp. 9–22) is reported at 419 F. 2d 1068.

JURISDICTION

The judgment of the court of appeals (Appendix B, *infra*, p. 23) was entered on December 12, 1969. On March 4, 1970, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including April 11, 1970. The jurisdiction of this Court is conferred by 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether employee taxes withheld, but not paid to the United States, by a debtor in possession during an arrangement under Chapter XI of the Bankruptcy Act constitute a trust fund, under Section 7501(a) of the Internal Revenue Code, that is not a part of the estate to be distributed in a subsequent bankruptcy proceeding.

STATUTES INVOLVED

The pertinent provisions of Section 64a of the Bankruptcy Act, as amended, 11 U.S.C. 104, 28 U.S.C. 960, and Section 7501(a) of the Internal Revenue Code of 1954 are set forth in Appendix D, *infra*, pp. 26–29.

STATEMENT

Halo Metal Products, Inc., filed a petition for an arrangement under Chapter XI of the Bankruptcy Act on Augst 18, 1967. On August 24, 1967, the referee entered an order allowing the debtor to remain in possession and to carry on its business, but requiring it to file monthly reports, to keep separate books and records of its operations during the arrangement proceedings, to set up separate bank accounts for its general, payroll and tax indebtednesses, and to make appropriate disbursements from these accounts. Halo failed, however, to comply with these requirements; it withheld income and F.I.C.A. taxes from the wages of its employees, but failed to deposit these taxes in the special tax account and did not pay them to the United States.

Subsequently, Halo was adjudicated a bankrupt on November 22, 1967. Previously the United States had filed a proof of claim in the Chapter XI proceeding for $1,075.02 of F.I.C.A. and income taxes withheld by the debtor during the arrangement. The United States filed a petition in the bankruptcy proceeding seeking to enforce the trust in its favor created under Section 7501(a) of the Internal Revenue Code through payment of the amount of the withheld taxes prior to payment of the costs and expenses of administration of the bankruptcy proceeding. The referee denied the government's petition, and the district court and court of appeals affirmed.

REASONS FOR GRANTING THE WRIT

The court of appeals has erroneously decided an important question involving the interaction of the Bankruptcy Act, the federal tax law, and the Judicial Code. As the court acknowledged, its decision is contrary to decisions of the Second, Sixth and Ninth Circuits. *City of New York* v. *Rassner,* 127 F. 2d 703 (C.A. 2); *In re Airline-Arista Printing Corp.,* 267 F. 2d 333 (C.A. 2), affirming *per curiam,* 156 F. Supp. 403 (S.D. N.Y.); *Hercules Service Parts Corp.* v. *United States,* 202 F. 2d 938 (C.A. 6); *United States* v. *Sampsell,* 193 F. 2d 154 (C.A. 9).

1. Section 7501(a) of the Internal Revenue Code of 1954 impresses a trust in favor of the United States upon taxes withheld by an employer from its employees, as follows:

> Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. * * *

The debtor in possession was authorized by the arrangement court to continue the operation of its business upon the condition that it place all withheld taxes in a special account in trust for the United States. This requirement was in accord with the further provision of 28 U.S.C. 960 that:

> Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

When a debtor in possession is displaced by a bankruptcy trustee, there is no break in the continuity of the relationship. *Reading Co.* v. *Brown*, 391 U.S. 471; see also 9 Collier, *Bankruptcy* (14 ed., 1969) par. 10.10, p. 510. Therefore, the statutory obligation imposed upon the debtor in possession to create the trust and to pay the trust's funds to the United States applied equally to its successor, the trustee in bankruptcy, who stands in the shoes of the debtor in possession. Thus, the trustee in this case was required to fulfill those trust obligations which his predecessor failed to carry out.

The court below conceded that the debtor in possession in the present case violated the governing stat-

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> estate to do so equitably. * * * Protection of a beneficiary of a trust whose funds have been misappropriated is a proper part of equitable administration. * * *

Indeed, this principle also applies under trust law generally where trust funds are diverted by an officer of the court. If the trust beneficiary were required to trace the res as a condition for recovery under such circumstances, the purpose for creating the statutory trust would be largely frustrated. See Bogert, *Trusts and Trustees* (2d ed., 1962), Sec. 922.

2. The court below based its conclusion principally upon a supposed overriding policy of the Bankruptcy Act against allowing the United States special treatment for its tax debts, citing, *inter alia, Nicholas* v. *United States,* 384 U.S. 678, 691. But, as the court below indicated, *Nicholas* involved the trustee's liability for *interest* on unpaid withheld taxes, which were admittedly not the subject of a Section 7501 trust. *Nicholas* expressly did not reach the issue of the treatment to be accorded the *principal* of withheld taxes. 384 U.S. at 691.

Contrary to the decision below, recognition in this case of the trust created under Section 7501(a) of the taxing statute would not conflict with the underlying principle of Section 64a(1) of the Bankruptcy Act. Section 7501(a) creates a trust fund for the amount of taxes withheld by the debtor in possession from wages paid to its employees. If not withheld for the Government, these monies would have been paid to the employees as wages. They are not a product of the business operations, but belonged to the Government

from the beginning. Consequently, such monies never became part of the bankrupt estate and were never subject to claims of its creditors, including those responsible for its administration.

Section 64a of the Bankruptcy Act governs only the distribution of the bankrupt estate to such unsecured creditors. Since this case is concerned solely with the ownership of the "amount of tax so collected or withheld," which is by the terms of the statute "a special fund in trust for the United States," and does not involve any question of priority of payment to unsecured creditors, Section 64a does not come into operation. As Mr. Justice Cardozo said in *Jennings* v. *United States F. & G. Co.*, 294 U.S. 216, 226: "A trust so created, to arise upon insolvency, is a preference under another name." This preference having been provided by Congress, in clear terms, for a good purpose, and in an equitable situation, should be recognized and enforced by the courts; in the circumstances of this case, the statute is an instance of "The power of the nation within the field of its legitimate exercise * * *." *Ibid.*

3. The issue in the present case is a recurring one. Not only does it exist potentially in every unsuccessful Chapter XI arrangement proceeding, but it can also arise in every Chapter X corporate reorganization proceeding and Chapter XII real property arrangement proceeding which terminates in a liquidating bankruptcy. It also may occur in straight bankruptcy proceedings where the trustee operates the business during the process of liquidation. We have been advised by the Internal Revenue Service that during the fiscal year 1968 34 corporate reorganizations were

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initiated, of which 19 ended in adjudications of bankruptcy; in the same year, 360 Chapter XI arrangement proceedings were commenced, of which 217 became liquidation bankruptcies. During the fiscal year 1969, 70 Chapter X, 867 Chapter XI, and 66 Chapter XII proceedings were commenced.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfuly submitted.

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JOHNNIE M. WALTERS,
Assistant Attorney General.
CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys.

APRIL 1970.

APPENDIX A

In the

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1969—SEPTEMBER SESSION, 1969

No. 17608

IN THE MATTER OF HALO METAL PRODUCTS, INC., AN ILLINOIS CORPORATION, UNITED STATES OF AMERICA, APPELLANT

v.

WILLIAM L. RANDALL, TRUSTEE, BANKRUPT, APPELLEE

ON APPEAL FROM THE MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

December 12, 1969

Before Hastings and Knoch, Senior Circuit Judges, and Dillin, District Judge.*

Hastings, Senior Circuit Judge. The district court affirmed an order of the referee in bankruptcy refusing to declare a trust in favor of the United States for income and social security taxes withheld from employees' wages by the bankrupt while acting as a

*Judge Dillin is sitting by designation from the Southern District of Indiana.

debtor-in-possession under an arrangement proceeding pursuant to Chapter XI of the Bankruptcy Act, 11 U.S.C.A. § 701, *et seq.* The United States appealed. We affirm.

Halo Metal Products, Inc., filed a petition for an arrangement under Chapter XI on August 18, 1967. On August 20, 1967, orders were entered allowing the debtor to remain in possession and requiring it to file monthly reports, to keep separate books and records of its operations as of August 18, 1967, to set up separate bank accounts for its general, payroll, and tax indebtedness, and to make appropriate disbursements therefrom.

While operating its business as a debtor-in-possession, Halo failed to file regular reports, failed to properly set up the separate bank accounts, failed to deposit in the tax accounts amounts withheld from employee wages as income and social security taxes, and failed to make payment of such taxes.

On November 22, 1967, Halo was adjudged a bankrupt. Pursuant to cour order, its physical assets were sold.

The United States filed a petition in the bankruptcy proceeding for an order imposing a trust in its favor on $1,075.02 of the bankrupt's estate and ordering payment to it of such amount prior to payment of the costs of administration. This amount represents the income and social security taxes withheld by the debtor-in-possession which were not paid over to the United States.

The United States contends such a trust is imposed by Section 7501(a) of the Internal Revenue Code of 1954, which provides:

> *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over

> such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

It is well settled that, absent such a trust, taxes incurred during a Chapter XI arrangement enjoy only a *pro rata* first priority with all other administrative expenses under Section 64a(1) of the Bankruptcy Act, 11 U.S.C.A. § 104(a)(1).[1] *See, e.g., Missouri* v. *Earhart,* 8 Cir., 111 F. 2d 992, 995 (1940) and cases cited therein.

The fund created by the sale of the bankrupt's physical assets is the only substantial asset of the estate and exceeds the Government's tax claim by a mere few hundred dollars. It is thus clear that if the Government is given a super priority under its trust fund theory, the claims for other administrative expenses will not be paid.

Three federal courts of appeal have accepted the Government's trust fund theory in cases presenting factual situations essentially identical to that before us.

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[1] "§ 104. Debts which have priority

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration * * *. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding * * * shall have priority in advance of payment of the unpaid costs and expenses of administration * * * incurred in the superseded proceeding. * * *.

The Second Circuit's decision in *City of New York* v. *Rassner,* 2 Cir., 127 F. 2d 703 (1942), is the first and still leading, case supporting the Government's position. It involved city sales taxes and a state statute making sellers trustees of such taxes for the city upon their collection. The court noted that a beneficiary must trace funds where mingling takes place prior to bankruptcy, but held tracing was unnecessary where a debtor-in-possession acting as an officer of the bankruptcy court mingled trust funds. The court reasoned that "if we hold that the city must now trace the funds, we state in effect that any beneficiary of a trust which is handled by an officer of a bankruptcy court must always protect himself by petitioning in advance for proper administration of the trust. Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it. As a court of equity, a bankruptcy court can hardly proceed on this assumption. It is the duty of the bankruptcy court in distributing an estate to do so equitably." 127 F. 2d at 706. (Footnote omitted.)

The court there recognized that "of course, an overriding policy of the Bankruptcy Act could prevent preferred satisfaction of even trust claims." *Id.* However, it concluded that no such policy was reflected by "the generalities of § 64, subd. a(1)." *Id.,* at 707.

Rassner was followed by the Ninth Circuit in *United States* v. *Sampsell,* 9 Cir., 193 F. 2d 154 (1951), and by the Sixth Circuit in *Hercules Service Parts Corp.* v. *United States,* 6 Cir. 202 F. 2d 938 (1953). Both cases involved federal income and social security withholding taxes and the predecessor statute to Section 7501(a).

The Second Circuit reaffirmed *Rassner* and applied it to federal taxes in In re Airline-Arista Printing

Corp., 156 F. Supp. 403 (S.D.N.Y. 1957) aff'd per curiam, 267 F. 2d 333 (1959). It held that the 1952 amendment to Section 64a(1)[2] granting priority to costs and expenses of an ensuing bankruptcy proceeding over costs and expenses of a superseded arrangement did not reflect a new "overriding policy of the Bankruptcy Act" which would compel a reversal of the *Rassner* rule.

With deference and for reasons hereinafter set out, we are unable to follow the *Rassner* line of decisions. We hold that the United States is not entitled to a super priority by virtue of Section 7501(a) of the Internal Revenue Code.

The Third Circuit has noted that the tax trust fund created by the first sentence of Section 7501(a) is limited by the second sentence of that section. "Thus, though such collections are considered by law to be held in trust, that trust is subject to the same limitations as are the taxes from which the trust arose. Here, that limitation is the structure of the Bankruptcy Act * * *." *In re Connecticut Motor Lines, Inc.*, 3 Cir., 336 F. 2d 96, 107–08 (1964).[3]

The Supreme Court, since the *Rassner* precedent, has recognized that the second sentence of Section 7501(a) may impose bankruptcy-created limitations

[2] See footnote 1, *supra*. The second quoted sentence was added by the 1952 amendment. 66 Stat. 426.

[3] The central issue decided in *Connecticut Motor Lines* was was that income and social security withholding taxes arising from wages earned prior to bankruptcy, but paid during bankruptcy, were not first priority "costs and expenses of administration" within Section 64a(1), but were fourth priority "taxes legally due and owing by the bankrupt" within Section 64a(4). The quoted passage came in response to the Government's argument that because the taxes were a trust fund, the Government need not file a proof of claim as required in fourth priority matters.

on the tax trust fund imposed by the first sentence. In *Nicholas* v. *United States,* 384 U.S. 678 (1966), the Court held that the United States was not entitled to post-bankruptcy *interest* on withholding taxes which accrued while the debtor was in possession under Chapter XI, but which were not paid until after the adjudication of bankruptcy. The Court then continued:

> We find no merit in the Government's alternative suggestion that the interest on two of the taxes here in question—those withheld from the wages of employees and those collected from the patrons of the cabaret—constitutes a trust fund over which the United States has an absolute priority under § 7501(a) of the Internal Revenue Code. * * * The second sentence of § 7501(a) specificaly provides that interest on such a trust fund is collectible in the same manner as the taxes from which the fund arose. Since we have already determined that no interest on any of the taxes here in question accrues beyond the period of the arrangement proceeding, no interest could accumulate on a trust fund composed of the withholding and cabaret taxes. 384 U.S. at 690–691, 86 S. Ct. at 1683–1684. (Footnotes omitted.)

The District Court of Colorado has applied this reasoning to the identical issue before us. It held "the second sentence of § 7501(a) means that the trust fund mentioned in the first sentence is nevertheless subject to the provisions of §64(a) of the Bankruptcy Act which establishes a priority for all expenses of administration, including taxes. So construed there is no conflict between § 7501(a) and § 64(a) * * *." *In Re Green,* 264 F. Supp. 849, 851 (1967).

We are persuaded that this construction is correct. It gives effect to both Congressional enactments. On

the one hand, it preserves the tax trust arrangement and thus leaves available to the Government certain favorable collection procedures. The legislative history of Section 7501(a) confirms this was the major goal of its enactment. The Senate Committee Report, S. Rep. No. 558, 73d Cong., 2d Sess., p. 53, noted:

> Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distraint. Section [7501(a)] * * * impresses the amount of taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes.

The Conference Report, H. Conf. Rep. No. 1385, 73d Cong., 2d Sess., p. 32, reflected the same purpose:

> "This amendment impresses taxes collected or withheld with a trust in favor of the United States and makes applicable for the enforcement of the Government's claim the administrative provisions applying to the assessment, collection, and payment of taxes."

On the other hand, this construction makes collection of the trust fund in bankruptcy situations subject to the usual bankruptcy priority rules and thus honors the policy decision of Congress reflected in Section 64 as to the relative merit of various claims upon the bankrupt estate.

But, even if we accept *arguendo* the Government's position that Section 7501(a) is intended to grant trust fund taxes a higher priority in bankruptcy than they are allowed by Section 64a(1) of the Bankruptcy Act, it avails the Government nothing. The Supreme Court has held on a number of occasions that where there is a conflict between the order of priorities set

out in the Bankruptcy Act and preferences given to the Government by nonbankruptcy legislation, the bankruptcy priorities should control. *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U.S. 152 (1912); *Davis* v. *Pringle*, 268 U.S. 315 (1925) *Missouri* v. *Ross*, 299 U.S. 72, 76 (1936).[4] *See also United States* v. *Key*, 7 Cir. 407 F. 2d 635, 638 (1969) and *United States* v. *Kalishman*, 8 Cir. 346 F.2d 514, 517 (1965).

As above noted, *Nicholas, supra*, held that bankruptcy law overrides the Section 7501(a) trust fund as to the *interest* on withholding taxes attributable to pre-bankruptcy operations by a Chapter XI debtor-in-possession. The Court expressly did not reach the question now before us concerning the *principal* of such taxes. However, its use of the following language indicates the relevance of *Guarantee Title* to that question:

> We need not here determine whether, with regard to the *principal* of those taxes, the general language of § 7501(a) overrides the strong policy of § 64a(1) of the Bankruptcy Act, which establishes a sharply defined priority that places all expenses of administration on a parity, including claims for taxes. Cf. *Guar-*

[4] The fact that in both *Guarantee Title* and *Pringle* the Court seems in part to base its decisions on the fact that the bankruptcy priority provision was enacted after the tax preference provision and changed the previous priority scheme in no way detracts from their precedential value for the instant case. Section 7501(a) is derived unchanged from an Act of May 10, 1934, c. 277, § 607, 48 Stat. 768. Present Section 64a(1) derives from the 1938 Chandler Act and represents a clear departure from pre-Chandler Act practice in reducing all costs of administration—including taxes—to a parity in the priority scheme. *See United States* v. *Kalishman*, 8 Cir., 346 F. 2d 514, 517 (1965), and 3A Collier on Bankruptcy 2051-52.

antee Co. v. *Title Guaranty Co.*, 224 U.S. 152; *Davis* v. *Pringle*, 268 U.S. 315; *Missouri* v. *Ross*, 299 U.S. 72,[5] 384 U.S. at 691.

Our reading of *Nicholas* affords no support for the *Rassner* conclusion that there exists no strong bankruptcy policy to override the preference the Government finds created by Section 7501(a). *See also United States* v. *Kalishman, supra* at 520; *In re Connecticut Motor Lines, Inc., supra* at 107–08; and 3A Collier on Bankruptcy 2070, n. 27.

We find such a strong policy in the very enactment of Section 64a(1). In enacting that subsection, Congress clearly rejected earlier priority schemes giving some administrative expenses higher priorities than others and provided that all such claims should share equally on a first priority basis. The statute gives no hint of any Congressional intent to continue the more favorable treatment of certain administrative expenses. *See* 3A Collier on Bankruptcy 2070 n. 27 at 2071.

Further indication of an overriding bankruptcy policy against the trust fund preference sought by the

[5] It should be noted that the Court may have implicitly decided the reserved issue in an earlier portion of its opinion when it said: "[T]axes incurred during the arrangement period * * * technically a part of the first priority under § 64a(1). The final sentence of that section, however, subordinates arrangement expenses within that priority to the expenses of the superseding bankruptcy administration. Tax claims incurred during Chapter XI proceedings are therefore in fact junior to claims for expenses incurred in subsequent bankruptcy proceedings." 384 U.S. at 687–88. Under the Government's theory the arrangement tax claims take priority over *all* claims for administrative expenses arising out of the bankruptcy proceeding. The Second Circuit specifically so held in *Airline-Arista*, 267 F. 2d at 334, in affirming on the opinion of the learned District Judge, 156 F. Supp. at 407.

Government may be gained from a study of two parallel lines of statutory development, one continually reducing and limiting the priority to be accorded taxes and the other regularly according a more and more favorable priority to administrative expenses. *See In Re Connecticut Motor Lines, supra* at 102–03, and 3A Collier on Bankruptcy 2046–109 and 2149–59. It is clear that if the trust fund theory is accepted, taxes will be paid at the expense of administrative costs. Such a result would be patently contrary to the strong and continuing Congressional policy evidenced by these statutory developments.

Until 1926 "taxes legally due and owing" were given first priority status above all else. *See* 3A Collier on Bankruptcy 2046–48 and 2155–56, and Bankruptcy Acts of 1800, 1841, 1867 and 1898. In that year, taxes were reduced to sixth priority behind, among other things, administrative expenses. Act of May 27, 1926, 44 Stat. 662. This priority was retained in the Chandler Act of 1938.[6] Act of June 22, 1938, 52 Stat. 883. However, that Act further reduced the preference accorded tax claims by making them subject for the first time to the general limitation period for filing claims. 11 U.S.C.A. § 93(n).[7]

On the basis of these amendments, the Supreme Court further reduced the special treatment given

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[6] Consolidation of some prior categories, however, resulted in taxes being numbered as the fourth priority in the 1938 Act.

[7] "§ 93 Proof and allowance of claims

* * * * *

(n) Except as otherwise provided in this title, all claims provable under this title, *including all claims of the United States and of any State or any subdivision thereof*, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed * * *. (Emphasis added.)

taxes by holding they were no longer entitled to a special exemption from the general prohibition against post-bankruptcy interest on claims against the estate. *City of New York* v. *Saper*, 336 U.S. 328 (1949).

The legislative assault continued with a 1966 amendment to Section 64a(4), 11 U.S.C.A. § 104(a)(4), which limited the fourth priority to "taxes * * * legally due and owing * * * *which are not released by a discharge in bankruptcy* * * *." Act of July 5, 1966, 80 Stat. 271 (Emphasis added.) The same legislation amended Section 17a(1), 11 U.S.C.A. § 35(a)(1), to make non-dischargeable only those taxes which became due and owing within three years prior to bankruptcy with certain exceptions.[8] The explanation of these amendments given in the House Report is particularly illustrative of the growing Congressional disfavor with the preferred treatment given tax claims under the Bankruptcy Act. Excerpts are set out in the margin.[9]

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[8] "§ 35. Debts not affected by a discharge

(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy [with certain exceptions].

One of the exceptions covers taxes "collected or withheld from others * * * but not paid over." This is an exception from a limitation on claims for pre-bankruptcy taxes which the Government must be able to trace in order to recover. However, we cannot find in this any support for the Government's position as to post-bankruptcy taxes which it seeks to recover not as taxes but as an administrative expense and which it is unable to trace into any property remaining in the bankrupt's estate.

[9] [T]here is no time limit under present law on the priority accorded taxes.

The result has frequently been that tax collectors, assured of a prior claim on the assets of a failing debtor and

In sharp contrast to this continual downgrading of tax claims has been the equally pronounced trend toward insuring the payment of administrative expenses.

Until 1926 claims for administrative expenses had been subordinate to tax claims. *See* 3A Collier on Bankruptcy 2046–48 and 2155–6, and Bankruptcy Acts of 1800, 1841, 1867 and 1898. In that year, they were placed ahead of taxes in the priority scheme. Act of May 27, 1926, 44 Stat. 662. However, the trustee's

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assured of the nondischargeability of uncollectible tax claims, have allowed taxes to accumulate and remain unpaid for long periods of time. With the proliferation of new taxes and the increased rates of old taxes, often little or nothing is left for distribution to general creditors who provided goods and services to the bankrupt.

The committee has received hundreds of letters from business firms all over the country complaining about this situation. Although a creditor can protect himself to some degree by requiring periodic financial statements from the bankrupt, there are cases in which the true extent of tax liability may not be known, even to the debtor, as where there are unsettled accounting or legal questions. Nor is a creditor protected from a dishonest debtor who issues a false statement of his tax liability. While this may result in barring the debtor's discharge, the Government still has a tax priority which may be large enough to preclude the creditor's participation in the distribution of the debtor's assets. *Ultimately, however, the issue would appear to resolve into whether the Government as a creditor should bear part of the economic burden of business failures through the loss of some of its tax claims* which it has allowed to accumulate over a long period of years.

* * * * *

The unlimited priority now enjoyed by taxes in bankruptcy proceedings in the United States is inconsistent with the practice in most commercial countries. H.R. Rep. No. 687, 89th Cong., 1st Sess. (1965). (Emphasis added.)

"costs and administrative expenses" were still subordinate to claims of the referee and of creditors for costs of preserving or recovering assets. *See* 3A Collier on Bankruptcy 2051–52. The 1938 Act included "costs and expenses of administration" in the first category of priorities so that they would have a *pro rata* first priority claim to the estate along with the two items that had preceded them prior to 1938. Act of June 22, 1938, 52 Stat. 883. In 1952 the Act was amended to give priority to administrative expenses of an ensuing bankruptcy proceeding over unpaid administrative expenses of a superseded proceeding. Act of July 7, 1952, 66 Stat. 426. This amendment clearly illustrates Congressional reasoning in preferring administrative expenses to all others. As stated in the Senate Report:

> Unless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceeding, ahead of all prior incurred and unpaid administration costs and expenses, there is always danger of a breakdown of administration. There should be assurance to the trustee in the ensuing proceeding that the costs and expenses incurred by him, such as bond premiums, insurance premiums, costs of conducting a public sale and compensation for his services and for the services of his attorney, will be paid out of the assets liquidated and administered by him ahead of the prior unpaid costs and expenses. Sen. Rep. No. 1395 on S. 2234, 82d Cong., 2d Sess., p. 4 (1952).

These statutory developments indicate both a growing recognition in the Congress of the inequity of extending to the Government extraordinary preferences over other creditors when a taxpayer-debtor experiences financial failure and also a growing real-

ization of the fact that sound bankruptcy administration for the benefit of creditors and Government alike depends upon insuring payment of the expenses necessarily incurred in such administration.

The Section 7501(a) trust fund theory advanced by the Government would subvert both of these strong bankruptcy policies. For that reason, we hold that even if Section 7501(a) is construed to create the super priority urged by the Government, it is overridden by the strong policies evidenced in Section 64(a) of the Bankruptcy Act.

In sum, we hold that when Section 7501(a) of the Internal Revenue Code and Section 64a(1) of the Bankruptcy Act are construed in light of the underlying policies, they do not conflict. The trust fund created by the former statute is, by the terms of that statute, subject to the limitations imposed by the latter statute. Further, we hold that even if we accept the Government's theory that Section 7501(a) creates a preference for post-bankruptcy tax claims higher than that accorded them by Section 64a(1), that preference is overridden by the strong bankruptcy policies reflected in Section 64 and in the legislative development of that statute to its present form. We find such a result consistent with the treatment by the Supreme Court of analogous questions in such cases as *Guarantee Title, Pringle, Ross* and *Nicholas.*

For the foregoing reasons, the memorandum order of the district court appealed from herein is affirmed.

AFFIRMED.

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 17608

FRIDAY, DECEMBER 12, 1969

IN THE MATTER OF HALO METAL PRODUCTS, INC., AN ILLINOIS CORPORATION, UNITED STATES OF AMERICA, APPELLANT

v.

WILLIAM L. RANDALL, TRUSTEE, BANKRUPT, APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

Before Hon. John S. Hastings, Senior Circuit Judge.

Hon. Win G. Knoch, Senior Circuit Judge.

Hon. S. Hugh Dillin, District Judge.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the memorandum order of the said District Court in this cause appealed from be, and the same is hereby, affirmed, with costs, in accordance with the opinion of this Court filed this day.

APPENDIX C

UNITED STATES DISTRICT COURT NORTHERN DISTRICT OF ILLINOIS (EASTERN DIVISION)

No. 67 B 6099

In the matter of Halo Metal Products, Co., Inc.

MEMORANDUM AND ORDER

This matter comes before the court on the petition of the government to review the decision of the Referee in Bankruptcy refusing to declare certain funds of the bankrupt a trust for the United States. The funds in question are withholding taxes withheld from wages of the employees of the debtor, but not paid over to the United States.

In its petition for review the government argues that under § 7501(a) of the Internal Revenue Code (26 U.S.C. § 7501(a)) when one is required to collect taxes from another and to subsequently pay the taxes collected to the government, those monies collected constitute a trust for the benefit of the United States. The Referee found that all priorities in bankruptcy matters should be determined pursuant to § 64(a) of the Bankruptcy Act (11 U.S.C. § 104) and that the trust fund concept of § 7501(a) should not be interpreted to change the scheme of priorities in the Bankruptcy Act. The government's position is supported by a number of court decisions. (*City of New York* v. *Rassner,* 2nd Cir., 127 F.2d 703 (1942); *United States* v. *Sampsell,* 9th Cir., 193 F.2d 154 (1951); *in re Air-*

line-Arista Printing Corp. (S.D.N.Y., 1957) 156 F. Supp. 403.)

These decisions, however, have been criticized by a number of more recent authorities. (*United States* v. *Kalishman,* 8th Cir., 346 F. 2d 514 (1965); *In re Connecticut Motor Lines, Inc.,* 3rd Cir., 336 F.2d 96 (1964); 3A Collier on Bankruptcy § 64.02, n27 at p. 2070; See also *Nicholas* v. *United States,* 384 U.S. 678 (1966)). They have also been expressly and unequivocally rejected by a recent District Court opinion. (*In re Green* (D.C., Col. 1967) 264 F.Supp. 849)

For the reasons set forth in these more recent authorities I find that the order of the referee in bankruptcy here certified for review should be and the same is hereby *affirmed.*

Enter:

CAMPBELL.
Chief Judge.

DECEMBER 11, 1968.

APPENDIX D

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 64 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, 874, and the Act of September 25, 1962, P.L. 87–681, 76 Stat. 570, 571] *Debts Which Have Priority.*—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as

now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection

and through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

* * * * *

[11 U.S.C. 104.]

28 U.S.C.:

SEC. 960. *Tax liability.*

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same ex-

tent as if it were conducted by an individual or corporation.

Internal Revenue Code of 1954:

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

* * * * *

[26 U.S.C. 7501.]

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No. ~~1407~~ 125

In the

Supreme Court of the United States

OCTOBER TERM, 1969

UNITED STATES OF AMERICA,

Petitioner,

vs.

WILLIAM L. RANDALL, Trustee,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Attorney for William L. Randall, Trustee
Respondent

The Scheffer Press, Inc.—ANdover 3-6850

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 1407

UNITED STATES OF AMERICA,

Petitioner,

vs.

WILLIAM L. RANDALL, Trustee,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF CASE

Neither a transcript of the record nor a summary thereof was provided in the Government's Petition For Review of the Referee in Bankruptcy nor one considered necessary by the referee (A.49).

On August 18, 1967 the present bankrupt filed a petition for relief as debtor in possession under Chapter XI of the Bankruptcy Act. On August 24, 1967 orders were entered allowing the debtor to remain in possession and requiring that it file monthly reports, keep separate books and records of its operation as of August 18, 1967 and that it set up separate bank accounts so as to make proper provision for general, payroll and tax matters. The

debtor conducted the business until November 22, 1967 at which time it was adjudged a bankrupt.

During the foregoing period of operation the debtor failed to file regular monthly reports and failed to properly set up the bank accounts as ordered with the result that the sum of $1,075.02 claimed by the government to be due for accrued withholding taxes was not deposited in the tax account. What happened to this sum does not appear of record.

Pursuant to order of court the bankrupt's physical assets were sold and the price realized from the sale exceeded by very little the amount of the government's tax claim. The government now seeks to subject these funds to a special trust. The money realized from the trustee's sale will be the only substantial asset of the estate so that if the government's trust fund theory is upheld there will not be sufficient funds remaining in the estate to meet administrative expenses.

REASONS FOR NOT GRANTING WRIT

While differing with the Government's position that the Court of Appeals erroneously decided an important question involving the interaction of the Bankruptcy Act, the federal tax law and the Judicial Code, the respondent does recognize a substantial conflict might be thought to exist among the Second, Sixth and Ninth Circuits, as asserted by the Government, and the ruling below, which, in turn, is supported by *United States* v. *Kalishman*, 8th Cir., 346 F.2d 514 (1965); *In Re Connecticut Motor Lines, Inc.*, 3rd Cir., 336 F. 2d 96 (1964); 3A *Collier On Bankruptcy* § 64.02, n. 27 at 2071.

However, *Nicholas* v. *United States*, 384 U.S. 678 (1966); seems to have adequately met and properly settled this question in the broad sweep of its holding, along with those in *Guarantee Title & Trust Co.* v. *Title Guaranty Co.*, 224 U.S. 152 and *Davis* v. *Pringle*, 268 U.S. 315.

The economic effect of the adoption of the government's position would be to stultify the administration of a substantial number of estates.

CONCLUSION

Unless it appears to the Court that the ruling below and the consonant rulings in the 8th and 3rd Circuits are not warranted by its own earlier decisions, referred to hereabove, in cognate matters, or, if warranted thereby, are not sufficiently dispositive of the issue, the writ ought not be granted.

Respectfully submitted:

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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 125

UNITED STATES OF AMERICA, PETITIONER

v.

WILLIAM L. RANDALL, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum and order of the district court (A. 50–51) are not officially reported. The opinion of the court of appeals (A. 53–63) is reported at 419 F. 2d 1068.

JURISDICTION

The judgment of the court of appeals was entered on December 12, 1969 (A. 64). On March 4, 1970, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including April 11, 1970 (A. 65). The petition was filed on April 9, 1970, and was granted on October 12, 1970 (A. 65). The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 7501(a) of the Internal Revenue Code of 1954, F.I.C.A. and income taxes withheld from salaries paid to employees by a debtor in possession during an arrangement under Chapter XI of the Bankruptcy Act constitute a trust fund that is not a part of the arrangement estate to be distributed to creditors in a subsequent liquidating bankruptcy proceeding.

STATUTES INVOLVED

The pertinent provisions of Section 64a of the Bankruptcy Act, as amended, 11 U.S.C. 104; 28 U.S.C. 960, and Section 7501(a) of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 23–26.

STATEMENT

Halo Metal Products, Inc., filed a petition for an arrangement under Chapter XI of the Bankruptcy Act on August 18, 1967 (A. 47, 54). On August 24, 1967, the referee entered an order allowing the debtor to remain in possession and to carry on its business, subject to the arrangement court's supervision and control (A. 17–19, 47, 54). Among other things, the referee's order required the debtor in possession to file monthly reports, to keep separate books and records of its operations during the arrangement proceedings, to open three separate bank accounts for its general, payroll and tax indebtedness, and to make appropriate disbursements from these accounts (A. 17–18). The full amount of salaries and wages paid to employees was to be credited against the payroll account, and checks for wages and for the withheld

income and F.I.C.A. taxes were to be submitted to the referee for approval and then paid. The checks for the withheld taxes were to be paid into the tax account. Withdrawals from this account were to be allowed only for payment of withheld taxes and welfare benefits. The referee instructed the debtor to make returns called for by law (A. 18–19).

Halo failed to comply with these requirements. Although it withheld income and F.I.C.A. taxes from the wages of its employees, it failed to deposit these taxes in the special tax account[1] and did not pay them to the United States as required by the arrangement court's order (A. 47, 54).

Subsequently, Halo was adjudicated a bankrupt on November 22, 1967 (A. 36, 47, 54). The United States had previously filed a proof of claim in the Chapter XI proceeding for payment of $1,075.02 of F.I.C.A. and income taxes withheld by the debtor in possession during the arrangement on the ground that under Section 7501(a) of the Internal Revenue Code of 1954 this amount was a special trust fund in favor of the United States. Thereafter, on December 22, 1967, the United States filed a petition in the bankruptcy proceeding seeking to enforce the trust in its favor created under Section 7501(a) through payment of the amount of withheld taxes prior to payment of the costs and expenses of administration of

[1] The debtor indicated in some of the reports which he filed that he had deposited the withheld taxes into a "temporary Trust Account." A. 20, 23–24, 27–28, 32, 40. The referee found, however, that the debtor had failed to set aside these funds (A. 48).

the bankruptcy proceeding (A. 37–38, 47, 54). The referee denied the government's petition, on the ground that the withheld taxes were merely administrative expenses of the bankrupt estate, required to share in the first priority for such expenses under Section 64a of the Bankruptcy Act (A. 44, 46–49). The district court agreed with the referee that "all priorities in bankruptcy matters should be determined pursuant to § 64a of the Bankruptcy Act * * * and that the trust fund concept of § 7501(a) should not be interpreted to change the scheme of priorities in the Bankruptcy Act" (A. 50–51). The court of appeals affirmed (A. 53–63).

SUMMARY OF ARGUMENT

I

The Court of appeals characterized the issue in this case in terms of the relative priorities of various administrative expenses of the bankrupt estate. This misconstrued the nature of the government's claim with respect to withheld taxes—which is not that they are owed as administrative debts of the bankrupt estate, but, rather, that they are "owed" exclusively by the employees from whose wages they were withheld, and are merely held by the employer as the government's collecting agent. They are, therefore, not an asset of the bankrupt estate.

This principle is reflected in the entire statutory scheme governing the withholding of taxes, and especially in Section 7501(a) of the Internal Revenue Code of 1954, in which Congress specifically imposed on withheld taxes a trust in favor of the United States. Section 64a(1) of the Bankruptcy Act, which gives equal prior-

ity to all administrative expenses, does not affect the government's right to the proceeds of the Section 7501 trust in this case, because that provision governs the distribution only of funds which are assets of the bankrupt estate. *Nicholas* v. *United States,* 384 U.S. 678, in which the Court denied the government's claim for interest on withheld taxes, does not control the question of the disposition of the principal amount of the trust fund. The Court in *Nicholas* specifically reserved decision of the latter question.

II

The Section 7501 trust created in this case was not defeated by the failure of the debtor in possession to segregate the withheld taxes in a separate bank account, and the consequent inability of the government to trace the *res* of the trust. The general requirements of tracing do not always apply in the case of trusts which are constructively imposed by statute or by operation of common law, because it is anomalous to make the beneficiary of such a trust dependent upon the formal acts of an involuntary trustee.

It would be particularly undesirable to apply the requirement of tracing in the present case, because here the constructive trustee, the debtor in possession, was a court-appointed officer of the bankruptcy proceeding, and had been specifically ordered by the referee to segregate the withheld taxes and pay them when due. To require tracing here "would be condoning improper action by a trustee so long as he could successfully get away with it." *City of New York* v. *Rassner,* 127 F. 2d 703, 706 (C.A. 2).

410-750—70——2

ARGUMENT

I. THE WITHHELD TAXES ARE SUBJECT TO A TRUST IN FAVOR OF THE UNITED STATES CREATED BY SECTION 7501(a), AND NEVER WERE PART OF THE ARRANGEMENT OR BANKRUPTCY ESTATE

Section 7501(a) of the Internal Revenue Code of 1954 (*infra*, p. 26) provides that federal taxes required by law to be withheld constitute "'a special fund in trust for the United States.'" In the present case, the courts below characterized the question presented as whether the trust imposed on withheld taxes by Section 7501(a) is superseded by the priority granted to all administrative expenses under Section 64a(1) of the Bankruptcy Act, *infra*, p. 23. In the view of the court of appeals, the determinative factor was that Congress, in enacting Section 64a(1),

> clearly rejected earlier priority schemes giving some administrative expenses higher priorities than others and provided that all such claims should share equally on a first priority basis. The statute gives no hint of any Congressional intent to continue the more favorable treatment of certain administrative expenses [A. 59-60].

As the court acknowledged, its decision is contrary to decisions of the courts of appeals for the Second, Sixth and Ninth Circuits. *City of New York* v. *Rassner*, 127 F. 2d 703 (C.A. 2); *In re Airline-Arista Printing Corp.*, 267 F. 2d 333 (C.A. 2), affirming *per curiam* 156 F. Supp. 403 (S.D.N.Y.); *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938 (C.A.

6); *United States* v. *Sampsell*, 193 F. 2d 154 (C.A. 9).[2]

By treating the issue in this case as a matter of the relative priorities of various administrative expenses of the bankrupt estate, the court of appeals has, we submit, fundamentally misconstrued the character of the taxes which an employer withholds from the wages of his employees. These withheld taxes are not owed by the employer to the United States as a "debt," or, in the case of an insolvent employer, as an administrative expense of the arrangement or bankrupt estate. Rather, these funds are held by the employer as the government's collecting agent and are in no sense part of the bankrupt estate. Like the sales tax in *In re E. Goldberger, Inc.*, 32 F. Supp. 615, 616 (E.D.N.Y.):

> At no time did this sum become a part of the estate of the bankrupt for general distribution. This amount must be paid to the city of New York before the payment of the expenses of administration, not because of priority, but due to the fact that the debtor was only the trustee of the money collected * * *.

Indeed, the entire statutory scheme governing the withholding of taxes by employers establishes that the withheld tax is "owed" exclusively by the employee, and the employer is "merely the collection agent for its taxpayer employees." *Eighth Street Baptist*

[2] The decision below is in accord with that in *In re Green*, 264 F. Supp. 849 (D. Colo.). See, also, *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (C.A. 3), which applied similar reasoning in the context of a related issue (see footnote 7, *infra*). Cf. *United States* v. *Fogarty*, 164 F. 2d 26 (C.A. 8).

Church, Inc., v. *United States*, 26 A.F.T.R. 2d 5540, No. 476–69 C.A. 10, decided, September 23, 1970; *Jules Hairstylists of Maryland, Inc.*, v. *United States*, 268 F. Supp. 511 (Md.), affirmed per curiam, 389 F. 2d 389 (C.A. 4), certiorari denied, 391 U.S. 934. The taxes themselves, of course, are required to be withheld from the "wages" of the employees, which are defined as the gross amount paid to the employee, not the net amount after deduction of the withheld taxes. See Sections 3121(a), 3102(a), and 3401(a) and 3403 of the Internal Revenue Code of 1954.[3] Once the employee's wages have been paid, the deducted amount is considered paid to him at that time (Section 3123), and the employee's tax liability with respect to that amount is considered to have been discharged (Section 31). If the employer withholds and pays to the United States an excessive amount, the employee, not the employer, is entitled to claim a refund or credit. See Treasury Regulations on Employment Tax (1954 Code), §§ 31.6402(a)–2(a)(2) and 31.6402(a)–2(b).[4] If the employer fails to pay over a withheld tax, Section 6672 of the Internal Revenue Code charac-

[3] See, also, Section 3502, 1954 Internal Revenue Code, which provides that the employee's portion of F.I.C.A. taxes shall not be deductible by him in computing his taxable income.

[4] The same scheme applies to excise taxes. For example, although liability for payment of a manufacturer's excise tax is imposed upon the seller, the incidence of the tax falls upon the purchaser, and the latter has the right to recover any overpaid amount. See Section 4061 of the 1954 Code. The seller is not entitled to a refund or credit of taxes paid by him unless he can show that he, and not the purchaser, bore the economic incidence of the tax, or the purchaser consented in writing to allow the seller to recover any refund. See Section 6416 of the 1954 Code.

terizes his obligation to the government not as a tax liability, but as a "penalty equal to the total amount of the tax * * * not * * * paid over."

Recognizing that withheld taxes are held by the employer as a collecting agent for the benefit of the United States, Congress enacted special provisions by which the United States can collect these taxes. In addition to the usual debt collection remedies applicable to an ordinary tax obligation, Congress in Section 7501(a) imposed on withheld taxes a constructive trust, which subjects the withheld amount to collection through trust remedies.[5] That Section provides:

> Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

This provision originated as Section 607 of the Revenue Act of 1934, c. 277, 48 Stat. 680, which was applicable to the withholding or collection of excise taxes. The Senate Committee Report, in recommending enactment of this language (there denoted as Section 606), explained its purpose and effect as follows

---

[5] See *In re Allied Electric Products, Inc.*, 194 F. Supp. 26, 30-31 (D. N.J.); see, also, *V Scott on Trusts* (3d ed.), Sec. 508.1; Bogert, *Trusts and Trustees* (2d ed.), Secs. 867, 921.

(S. Rep. No. 558, 73d Cong., 2d Sess., p. 53 (1939-1 Cum. Bull. (Part 2) 586, 626)):

> Existing law provides with respect to a number of taxes that the amount of the tax shall be collected or withheld from the person primarily liable by another person, who is required to return and pay to the Government the amount of the taxes so collected or withheld by him. This is true, for example, in the case of the taxes on admissions, checks, and telephone and telegraph services. Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distraint. Section 606 of the bill as reported impresses the amount of taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes.[6]

The consequence of this statutory scheme in the instant case is that, when the debtor in possession paid the wages from which the taxes in question were deducted, the withheld funds were taken out of the arrangement estate and, by virtue of Section 7501(a)

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[6] The Conference Report confirmed this result as follows (H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 32 (1939-1 Cum. Bull. (Part 2) 627, 639-640)):

> This amendment impresses taxes collected or withheld with a trust in favor of the United States and makes applicable for the enforcement of the Government's claim the administrative provisions applying to the assessment, collection, and payment of taxes. There is no comparable provision in the House bill. The House recedes with an amendment changing the section number.

deemed to be held as "a special fund in trust for the United States." The taxes could not be considered administrative expenses of the bankruptcy estate under Section 64a not only because, as taxes, they were owed only by the employees, but also because the withheld funds were not in any sense assets of the estate and, therefore, could not be used to discharge debt liabilities of the estate. This result is not unfair to respondent's unsecured creditors, whose priorities are established by Section 64a of the Bankruptcy Act, because these creditors should not have expected to receive payment from assets which did not belong to the bankrupt company and which the bankruptcy court had previously ordered to be paid over to the government. Indeed, it is hardly likely that Congress, when it chose to utilize employers as collection agents for the taxes of their employees, intended to bestow a windfall on the employers' creditors, at the government's expense.

In support of its holding, the court below cited the second sentence of Section 7501(a), which provides that the amount of the trust fund created by that Section "shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose." In the court's view, this provision "makes collection of the trust fund in bankruptcy situations subject to the usual bankruptcy rules * * *" (A. 58), and requires classification of the taxes withheld by the debtor in

possession as administrative expenses of the arrangement estate.[7]

It is difficult to understand how the court of appeals found such a design in Section 7501(a). The second sentence of that provision obviously should not be read in isolation from the first sentence's express imposition of a *trust* in favor of the United States. The brief committee report on the predecessor of Section 7501(a), quoted in its entirety above (*supra*, p. 10), clearly indicates that a trust was imposed on withheld taxes in order to *expand* the collection remedies available to the government with respect to these funds by providing the remedies applicable both to tax debts and to trusts. Indeed, the committee report indicates Congress' belief that, in the absence of Section 7501, the government could not even avail itself of the special tax collection remedies, such as distraint, against withholding employers, on the theory that employers are not considered taxpayers with respect to withheld taxes, so that the reference in Section 7501 to tax collection remedies was in itself an expansive provision. Even without this explicit legislative history, it would have been self-contradictory for Congress to have imposed a trust on withheld

[7] The court of appeals for the Third Circuit has also read the second sentence of Section 7501 in the manner suggested by the court below. *In re Connecticut Motor Lines, Inc.*, 336 F. 2d 96. The court there held that withheld taxes arising from wages earned prior to bankruptcy but paid during bankruptcy were fourth priority "taxes legally due and owing by the bankrupt" under Section 64a(4) of the Bankruptcy Act.

taxes and, at the same time, to have restricted the government exclusively to the rules of assessment, collection, and payment applicable to ordinary tax debts. And, of course, an interpretation of this provision which would deny the government trust benefits only in a bankruptcy situation would deprive the government of this statutory protection at precisely the time when it is most needed.

This Court's decision in *Nicholas* v. *United States*, 384 U.S. 678, does not preclude recognition of the Section 7501 trust imposed here. *Nicholas* also involved a Chapter XI arrangement which failed and was succeeded by a liquidating bankruptcy. During the Chapter XI proceeding the debtor in possession collected excise taxes from its customers and withheld taxes from its employees which it failed to place in a trust fund for the United States. When payment of the taxes became due the debtor had been adjudicated a bankrupt, and the bankruptcy trustee failed to pay the taxes. The United States filed a proof of claim in the ensuing bankruptcy proceeding for the principal of the taxes plus delinquency penalties for the trustee's failure to file timely returns, and also for interest on the unpaid taxes. The trustee conceded that the government was entitled to payment of the principal amount of the taxes as an administrative expense of the liquidating bankruptcy. The bankruptcy estate was sufficiently large so that it was immaterial whether the taxes were paid as administrative expenses under Section 64a(1) or as trust fund taxes, and this issue was never involved in that case. With respect to the payment of interest, the govern-

ment contended, *inter alia,* that the *Rassner* line of decisions (*supra,* pp. 6–7), which had been applied only to the unpaid principal amount of taxes, should be extended to interest on the taxes.

This Court, recognizing that interest payments may have to be made out of the assets of the estate, denied the government's claim for interest on the withheld taxes in *Nicholas* because of the "broad equitable principle," inapplicable to the principal amount of the taxes,

> that creditors should not be disadvantaged * * * by legal delays attributable solely to the time consuming procedures inherent in the administration of the bankruptcy laws [384 U.S. at 683].

With respect to the government's alternative argument that the interest should be considered part of the 7501(a) trust fund, the Court pointed out (384 U.S. at 691) that the second sentence of Section 7501(a)

> specifically provides that interest on such a trust fund is collectible in the same manner as the taxes from which the fund arose. Since we have already determined that no interest on any of the taxes here in question accrues beyond the period of the arrangement proceeding, no interest could accumulate on a trust fund composed of the withholding and cabaret taxes.

This holding with respect to interest does not deny the congressional purpose to expand the collection remedies available to the government with respect to the withheld taxes themselves. The Court specifically reserved (384 U.S. at 691) the significantly different question whether the Bankruptcy Act destroys

the trust explicitly imposed on the principal amount of the taxes by Section 7501—which in terms refers only to the taxes themselves.

Finally, the court of appeals, in support of its decision, referred to

> two parallel lines of statutory development, one continually reducing and limiting the priority to be accorded taxes and the other regularly according a more and more favorable priority to administrative expenses [A. 60].

The statutory developments invoked by the court have gradually reduced the priority formerly accorded to the government's claims for tax debts accruing prior to bankruptcy proceedings,[8] and have increased the priority of administrative expense claims and eliminated subpriorities within the category of administrative expenses. However, the cited statutes, the implications of which the court below has in some respects considerably exaggerated,[9] have no bearing

[8] See 3A Collier on *Bankruptcy*, pp. 2046–2048, 2155–2156.

[9] The opinion states, for example, that the amendment to Section 64a(1) contained in the Act of July 7, 1952, 66 Stat. 420, Sec. 19(a), "clearly illustrates Congressional reasoning in preferring administrative expenses to all others." A. 62–63. This amendment changed the existing rule that where a bankruptcy follows a debtor relief proceeding which has failed, and the estate available for distribution after liquidation in the ensuing bankruptcy is not sufficient to pay the administration costs of both proceedings, the arrangement and bankruptcy costs share pro rata in the estate's assets. Under the 1952 amendment, those costs necessary to liquidate and close the estate prevail over administrative expenses during the prior arrangement period. See S. Rep. No. 1395, 82d Cong., 2d Sess., p. 4. As the district court pointed out in *In re Airline-Arista Printing Corp.*, 156 F. Supp. 403, 406 (S.D. N.Y.),

> In the Rassner case the court recognized that "Of course, an overriding policy of the Bankruptcy Act could prevent

on the instant case, because the government is not seeking here to enforce payment of its claim out of the bankrupt estate, either as a claimant for pre-bankruptcy taxes under Section 64a(4) or as an administrative expense claimant under Section 64a (1). Instead, the government is merely seeking to enforce its right to the proceeds of a statutory trust imposed on funds which are not part of the bankruptcy estate, and the disposition of which is in no way affected by the cited provisions.[10] The court's

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preferred satisfaction of even trust claims." The question here is whether the 1952 amendment either by express language subordinated such a claim as this to bankruptcy administration expenses, or enunciated such an "overriding policy." I do not believe it did either.

There is nothing in the language of the 1952 amendment which expressly changes the rule laid down in the Rassner, Hercules Service and Sampsel cases. The amendment deals with the respective priorities between costs and expenses of administration incurred in ensuing bankruptcy and in proceedings superseded thereby. It does not attempt to negative any priority granted by statute or decision to a trust *res* in the coming into the hands of a debtor in possession in a superseded proceeding.

[10] Indeed, in at least one instance, the legislation cited by the court of appeals supports the government's theory in this case. The amendments to Sections 17a(1) and 64a(4) contained in the Act of July 5, 1966, P.L. 89–496, 80 Stat. 270, discharged claims for taxes which had become due and owing more than three years prior to bankruptcy, with certain enumerated exceptions, and retained a priority only for those tax claims which were not thereby discharged. One of the exceptions to discharge covers taxes "collected or withheld from others * * * but not paid over." The inclusion of a special exception for taxes withheld more than three years prior to bankruptcy shows Congress did not intend to impose the restrictions applicable to ordinary tax debts on the collection of these special funds in trust. The court below dismissed the relevance of this exception to the instant

reliance on these provisions is a further indication that it fundamentally misconstrued the nature of the government's claim.

II. THE FAILURE OF THE DEBTOR IN POSSESSION TO SEGREGATE THE WITHHELD TAXES DID NOT DEFEAT THE TRUST CREATED BY SECTION 7501(a)

The court of appeals did not specifically address itself to the respondent's argument below that the trust imposed on the withheld taxes was defeated by the failure of the debtor in possession to comply with the referee's order requiring the debtor to place the withheld taxes in a separate account, and, consequently, by the government's inability to trace the *res* of

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case with the rather confusing explanation that the government seeks to recover withheld taxes here "not as taxes but as an administrative expense * * *." R. 61, fn. 8. On the contrary, the government seeks to recover these funds neither as tax debts nor as administrative expenses, but as funds held in trust.

It is of relevance here that this legislation as originally drafted in 1957 (H.R. 2171, 85th Cong., 1st Sess.) contained only two exceptions to discharge, *viz.*, where a taxpayer failed to file a return, and where he filed a false or fraudulent return. The Treasury opposed this proposal and, among other things, requested that a specific exception to discharge be included for "liabilities resulting not from the bankrupt's failure to pay his own taxes but from his failure to keep intact money which he had obtained from others as a trustee for the Government" (H. Rep. No. 2535, 85th Cong., 2d Sess., p. 6). Although other exceptions to discharge were included in later bills, the House Judiciary Committee did not include any specific exception for taxes collected or withheld from others on the ground that such an exception was unnecessary, presumably because it believed that the trust imposed on these taxes precluded their discharge (see H. Rep. No. 735, 86th Cong., 1st Sess., p. 5). Following further requests by the Treasury in 1961 (H. Rep. No. 372, 88th Cong., 1st Sess., p. 6; S. Rep. No. 1134, 88th Cong., 2d Sess., pp. 7, 9), the House Judiciary Committee acceded to the Treasury's request and added this exception to Section 17a(1) by H.R. 3438, 88th Cong., 1st Sess., Sec. 2. This amendment was later enacted by the Act of July 5, 1966, P.L. 89-496, 80 Stat. 270, Sec. 2.

the trust. Indeed, the court's decision appears to be based on the broad rationale that a Section 7501 trust should not be recognized in a bankruptcy situation regardless of whether the *res* of that trust can be traced.

In any event, we submit that a Section 7501 trust, such as that created in this case, is not destroyed by the mingling of the trust fund with the assets of the arrangement estate. To hold otherwise would, as shown above, throw into the bankrupt estate funds which under the withholding provisions and Section 7501 were taken out of the estate at the time that the wages in question were paid to the debtor's employees. The requirement for tracing in the ordinary trust situation is intended, among other things, to prevent other creditors from being unfairly harmed. See 4A *Collier on Bankruptcy,* par. 70.25.[2] It is difficult to see how creditors can be unfairly harmed by not receiving repayment from funds which were not an asset of the estate to begin with.

Furthermore, the courts and the leading commentators agree that the general requirement of tracing the *res* should not always apply in the case of trusts which are constructively imposed by statute or by operation of common law. See, *e.g., In re Grigsby-Grunow,* 80 F. 2d 478 (C.A. 7); V Scott on *Trusts,* Sec. 521; Bogert, *Trusts and Trustees,* Sec. 921; cf. *Adams* v. *Champion,* 294 U.S. 231, 238. The rationale of these authorities is that it is anomolous to make the beneficiary of such a trust dependent upon the formal acts of a trustee, such as the debtor in possession in the instant case, whose role as trustee is imposed

upon him by operation of law rather than by mutual agreement of the trustee and the creator of the trust.

The considerations in favor of easing the requirement of tracing are particularly strong in a case such as this, in which the constructive trustee is a court-appointed officer in an equity proceeding, for to require tracing in such a case would allow the misconduct of a court-appointed officer to defeat the beneficiary's rights to the trust fund. For this reason, Professor Scott, after examining the various rules as to when tracing should be required, concludes that the equitable rule is that

> Where the funds are received by a public officer, such as a receiver or trustee in bankruptcy, the owner of the funds is entitled to priority with respect to the funds so received without further tracing [*Scott on Trusts,* Sec. 521].

In support of this rule, Professor Scott cites the *Rassner* and *Hercules* decisions, *supra,* in which the courts focused on the importance of requiring that court-appointed officers perform their obligations. As Judge Clark explained for the court in *Rassner,* 127 F. 2d at 706,

> If the debtor in possession failed to segregate the taxes collected from vendees, it did so under the control of the court. * * * If we hold that the city must now trace the funds, we state in effect that any beneficiary of a trust which is handled by an officer of a bankruptcy court must always protect himself by petitioning in advance for proper administration of the trust.

> Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it. As a court of equity, a bankruptcy court can hardly proceed on this assumption. It is the duty of the bankruptcy court in distributing an estate to do so equitably.[11]

In the present case the referee, pursuant to Halo's petition for an arrangement under Chapter XI of the Bankruptcy Act, allowed Halo to remain in possession of its business during the arrangement and thus appointed Halo an officer of the court for the duration of the arrangement. The referee, in accord with 28 U.S.C. 960, authorized the payment of wages to Halo's employees and specificially ordered the debtor to place the withheld taxes in a special fund, and to make timely payment of those taxes.[12] When the Chapter XI arrange-

[11] Judge Clark also pointed out (127 F. 2d at 706):

> The city could hardly seek fine or imprisonment of debtor or its officers for failure to segregate funds—assuming the penal provisions, Administrative Code, c. 41, Tit. N, § 41-17.0, as amended by Local Laws 1940, p. 362, go that far—because the status of the debtor as under court control would be a defense. The most that the city could seek would be a court order directing the debtor in possession to keep sales tax receipts separate from the ordinary transactions of the business, in other words, to obey the sales tax law.

[12] 28 U.S.C. 960 (App. *infra*, p. 25) provides that "[a]ny officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

ment was superseded by the liquidating bankruptcy, and the debtor in possession was displaced by the respondent bankruptcy trustee, the trustee inherited all the obligations of the debtor in possession, including the obligation to pay over to the United States the funds held in the Section 7501 trust. See *In re Wil-Low Cafeterias, Inc.*, 111 F. 2d 83 (C.A. 2); 8 *Collier on Bankruptcy*, par. 6.32.[13] This Court should not allow the respondent trustee to invoke the misconduct of his predecessor in order to defeat the trust to which the United States is legally entitled.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed, and the case

[13] Respondents have not disputed that the debtor in possession was an officer of the court, and that respondent, as the debtor's successor, inherited his obligations. Section 302 of the Bankruptcy Act, as amended (11 U.S.C. 702), provides that "the date of adjudication shall be taken to be the date of the filing of the petition [for arrangement] under section 321 or 322." Section 378(a) (11 U.S.C. 778) provides that a bankruptcy proceeding which follows a Chapter XI proceeding "shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter [XI] was filed." Section 342 (11 U.S.C. 742) gives a debtor in possession "all the powers of a trustee appointed under this act, subject, however, at all times to the control of the court"; and under Section 343 (11 U.S.C. 743), "The receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor." See *Reading Co.* v. *Brown*, 391 U.S. 471.

should be remanded for appropriate enforcement of the trust in favor of the United States.

Respectfully submitted.

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DECEMBER 1970.

APPENDIX

Bankruptcy Act, c. 541, 30 Stat. 544:

Sec. 64 [as amended by Sec. 1, Act of November 28, 1967, P.L. 90–157, 81 Stat. 511] DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases,

and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding, including expenses necessarily incurred by a debtor in possession, receiver, or trustee in preparing the schedule and statement required to be filed by section 238, 378, or 483, shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling, or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term 'traveling or city salesman' shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts

and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c of section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy."

(11 U.S.C. 104)

28 U.S.C.:

SEC. 960. *Tax liability.*

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

* * * * *

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No. 125

In the

Supreme Court of the United States

OCTOBER TERM, A.D. 1970

UNITED STATES OF AMERICA,

Petitioner,

vs.

WILLIAM L. RANDALL,

Trustee.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit.

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

QUESTION PRESENTED

"Whether, under Section 7501(a) of the Internal Revenue Code of 1954, Social Security and income taxes withheld from salaries paid to employees by a debtor in possession during an arrangement under Chapter XI of the Bankruptcy Act constitutes a trust fund that is not a part of the arrangement estate to be distributed to creditors in a subsequent liquidating bankruptcy proceedings" is not precisely the question presented by the record (Gov't's Br. 2).

The question presented is whether when the debtor in possession fails to deposit Social Security and income tax funds withheld and the Government is unable to trace these funds, it should, nonetheless, be entitled to have a trust impressed on the proceeds realized from the sale of the debtor's physical assets and be favored thereby even to the virtual exhaustion of the assets of the estate, contrary to the priorities of Section 64a of the Bankruptcy Act?

STATEMENT

It is not altogether accurately asserted by the Government, in the "statement" portion of its brief, that the referee denied its petition in the bankruptcy proceedings to enforce a trust in its favor under Section 7501(a) of the Internal Revenue Code of 1954 through payment of the amount of withheld taxes prior to the payment of the costs and expenses of administration (Gov't's Br. 3-4).

The facts are that the referee allowed the Government's petition as to withheld taxes deposited by the debtor (of which there proved to be none) but denied further imposition of a trust on all other assets of the estate (A. 44).

SUMMARY OF ARGUMENT

Inasmuch as Section 7501(a) of the Internal Revenue Code of 1954 and Section 64a(1) of the Bankruptcy Act both deal with tax obligations, they should be construed, if possible, to give effect to both.

Construing the trust created by the first sentence of the former to be expressly limited to non-bankruptcy matters by the second sentence thereof permits effect to be given to both enactments.

The Government thereby retains favorable collection procedures against persons collecting or withholding taxes from others and, yet, the bankruptcy priorities are preserved when that Court intervenes.

On the other hand, should these statutes be held irreconcilable then the preference accorded the Government under Section 7501(a) of the Internal Revenue Code of 1954 must, under discernible congressional purpose and under the precedents, yield to the bankruptcy priorities.

To urge, as the Government does, that the withheld taxes are not an asset of the bankrupt estate but, notwithstanding, its trust should be impressed on all the other funds that are assets of the estate is hardly equitable, one would think, to those creditors and court officers whose goods and services created these assets and, particularly, where the withheld taxes were never possessed, in any form, by the trustee in bankruptcy and the estate would thereby be denuded (A 47-48).

ARGUMENT

I. WHILE WITHHELD TAXES ARE SUBJECT TO A TRUST IN FAVOR OF THE UNITED STATES CREATED BY SECTION 7501(a), THAT TRUST SHARES THE SAME LIMITATIONS IN BANKRUPTCY AS THE TAXES FROM WHICH IT AROSE

The position of the Government that the provisions of Section 7501(a) of the Internal Revenue Code of 1954 create a tax trust fund that is no part of a bankrupt's estate, but should, even so, enjoy a super-priority as to its unrelated assets, irrespective of the circumstances, appears to be supported by the courts of appeal in the Second, Sixth and Ninth circuits: *City of New York* v. *Rassner*, 127 F.2d 703 (C.A.2); *In re Airline-Arista Printing Corp.*, 267 F.2d 333 (C.A.2); *Hercules Service Parts Corp.* v. *United States*, 202 F.2d 938 (C.A.6); *United States* v. *Sampsell*, 193 F.2d 154 (C.A.9).

On the other hand, the court below (A. 53) and the Third Circuit Court, *In re Connecticut Motor Lines, Inc.*, 336 F.2d 96, together with the District Court of Colorado, *In re Green*, 264 F. Supp. 849, hold to the view that taxes held under the provisions of Section 7501(a) are subject to the priorities of Section 64a of the Bankruptcy Act when circumstances require the construction of both.

This would seem to be the state of the cases in the circuits that have dealt with the issue and no ready resolution is presently available except to the extent that this Court spoke to the point in *Nicholas* v. *United States*, 384 U.S. 678, 687-691, where it was stated that "taxes incurred during the arrangement period are expenses of

the Chapter XI proceedings and are therefore technically a part of the first priority under Section 64a(1)".

The Court then noted, at the same place, that these expenses were further subordinated to the expenses of the superseding bankruptcy proceedings by the Congress.

While this opinion was considering income taxes and social security taxes withheld during an arrangement, as in the present case, the issue before the Court was expressly limited to interest thereon accruing after bankruptcy.

Nevertheless, and to that extent, it flatly held that Section 7501(a) by its own language was limited by the bankruptcy precedents and that no trust fund existed as to that interest, reserving the question as to the effect of Section 7501(a) with respect to the principal of the taxes against which the Government sought no trust.

That question now presents itself.

The respondent urges upon the Court the view that a harmonizing construction of the two statutes involved, *Rosenberg* v. *United States*, 346 U.S. 273, 294, would recognize the existence of the Section 7501(a) trust all the way to the door of the bankruptcy court but not inside.

In this manner, the Government has the advantage of strong, administrative measures to protect withheld tax funds from being used by solvent or insolvent employers, and the like, as their own "float" prior to due date which appears to have been the intention of this action of Congress. The *Conference Report, H. Conf. Rep.* No. 1385, 73rd Cong., 2d Sess., P. 32; *The Senate Committee Report, S. Rep.* No. 558, 73rd Cong., 2d Sess., P. 53.

On the other hand, where one liable under Section 7501(a) is not subjected to those strong measures before entering the bankruptcy court, either on his own petition or involuntarily, the trust fund theory ought to dissipate in the face of the limiting language of Section 64a of the Bankruptcy Act and the bankruptcy precedents, assigning the Government then to that precise position in the order of priority established by Congress in an effort to deal evenhandedly with all having claims against the bankrupt, including the Government.

Should, however, these statutes be found not reconcilable, then the precedents of this Court, holding that general non-bankruptcy enactments seeking to create preferences contrary to the bankruptcy priorities cannot prevail, ought to settle the matter. *Guarantee Title & Trust Co.* v. *Title Guarantee & Surety Co.*, 224 U.S. 152; *Davis* v. *Pringle*, 268 U.S. 315; *Missouri* v. *Ross*, 299 U.S. 72; *United States* v. *Key*, 407 F.2d 635 (C.A.7); *United States* v. *Kalishman*, 346 F.2d 514 (C.A.8).

Downgrading of tax claims, moreover, would seem to have been the continuing purpose of Congress since 1926, as noted in the opinion below, *United States* v. *Randall*, 419 F.2d 1068, 1073-1075, when, after more than a century of preference, it withdrew from the Government first priority status, above all else, for tax claims. *3A Collier On Bankruptcy*, 2046-48 and 2155-56; when it placed these claims in sixth priority which positioning was retained in the *Chandler Act* of 1938, Act of June 22, 1938, 52 Stat. 883; when it, also, in the same act held tax claimants to ordinary filing period limits; and when, in the Act of July 5, 1966, 80 Stat. 271, it made dischargeable all taxes due and owing more than three years prior to bankruptcy, except those withheld or collected from others but not paid over.

This persistent policy of Congress is forcefully contrasted in the opinion below, at the same place, with a corresponding upgrading of the priority of administrative expenses. The opinion below, again at the same place, cites *Sen. Rep.* No. 1395 S. 2234, 82d Congress, 2d Sess., P.4, among the other illustrative sources, thusly:

> "Unless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceedings, ahead of all prior incurred and unpaid expenses, there is always a danger of a breakdown of administration. There should be assurance to the trustee in the ensuing proceedings that the costs and expenses incurred by him, such as bond premiums, insurance premiums, costs of conducting a public sale and compensation for his services and for the services of his attorney, will be paid out of the assets liquidated and administered by him ahead of the prior unpaid costs and expenses."

Should the Government's theory be sustained in this case, the "breakdown of administration" sought to be avoided by the Congress would result. (A. 55).

However persistently and imaginatively the Government argues here that it does not seek to enforce its claim out the bankrupt's estate but, instead, to the proceeds of a statutory fund, the plain fact is that there is no statutory fund.

There is no statutory fund because the trustee in bankruptcy never had tax withholdings delivered to him in any form. The only assets available for satisfaction of the claims of the Government, therefore, or for any other purposes, are the proceeds from the sale of the bankrupt's physical assets which hardly exceed the Government's demand. (A. 47-48).

II. WHILE THE FAILURE OF THE DEBTOR IN POSSESSION TO SEGREGATE THE WITHHELD TAXES MAY NOT HAVE DEFEATED THE TRUST CREATED BY SECTION 7501(a) A RIGHT WAS NOT ALSO CREATED THEREBY TO A SUBSTITUTE RES FROM THE UNRELATED ASSETS OF THE BANKRUPT TO THE HARM OF OTHER CREDITORS

The Government protests under this point that the Court below did not treat with the argument that the failure of the debtor in possession to segregate the withheld funds does not defeat the trust even though the Government cannot trace the funds.

Impliedly, and at times expressly, this tracing failure argument by the Government suggests that the funds in this case are so commingled among the bankrupt's other assets that identification is the problem.

This, as has been stated before, is not the fact. (A. 47-48).

The Government cites a number of authorities on general equity propositions to support its position that the *res* of a constructive trust need not be traced in cases such as this because tracing is only required when necessary to protect others from unfair harm and that these creditors cannot be harmed by not receiving payment from funds which were never properly an asset of the estate.

However, the argument here is not, as the Government urges, but instead, is whether a substitute *res* should be provided when to permit this event would be to indeed harm other creditors and, later, court administrators by depriving them of access to apparent assets which led

them initially to reasonably and substantially change their positions in reliance thereon.

It seems unlikely that the Congress had such an unfair purpose in mind when it provided for the withholding trust.

It seems likely, if not inarguable, on the other hand, that to avoid just such interpretation of the first sentence of Section 7501(a) it limited the effect of the trust in the second sentence.

CONCLUSION

An orderly administration of matters in bankruptcy requires that the question presented be settled by this Court's affirming the Court below.

Respectfully submitted,

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NOTE: Where it is deemed desirable, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED STATES *v.* RANDALL, TRUSTEE IN BANKRUPTCY

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 125. Argued February 22, 1971—Decided March 24, 1971

The debtor corporation, kept in possession of its business by court order under Chapter XI of the Bankruptcy Act, did not comply with requirements that it deposit withheld taxes in a special tax account. It was later adjudicated a bankrupt, and the United States asked the bankruptcy court to pay the amount of withheld taxes prior to payment of costs and expenses of the bankruptcy proceedings, pursuant to 26 U. S. C. § 7501 (a), which provides that the amount of withheld taxes "shall be held to be a special fund in trust for the United States." The referee denied the request, and the District Court and the Court of Appeals agreed. *Held:* Section 64 (a)(1) of the Bankruptcy Act, which is an overriding statement of federal policy on the question of priorities, clearly provides that the first priority in payments from bankrupt estates belongs to the costs and expenses of administration incurred in the bankruptcy proceedings. Pp. 2–5.

419 F. 2d 1068, affirmed.

DOUGLAS, J., delivered the opinion of the Court, in which HARLAN, BRENNAN, WHITE, and MARSHALL, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which BURGER, C. J., and BLACK and STEWART, JJ., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 125.—October Term, 1970

United States, Petitioner, v. William L. Randall, Trustee.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[March 24, 1971]

Mr. Justice Douglas delivered the opinion of the Court.

Halo Metal Products, Inc. (the debtor) was kept in possession of its business by court order under Chapter XI of the Bankruptcy Act. The order required it to open three separate bank accounts for its general, payroll, and tax indebtedness and to make appropriate disbursements from those accounts. Salaries and wages paid were to be credited against the payroll account and checks for wages and for withheld income and social security taxes were to be paid after approval by the referee. Checks for the withheld taxes were to be paid into the tax account. Withdrawals from this account were to be allowed only for payment of withheld taxes and welfare obligations.

The debtor did not comply with those requirements. Although it withheld income and taxes from the wages of its employees, it did not deposit them in the special tax account and did not pay them, as required, to the United States.

Later the debtor was adjudicated a bankrupt. The United States, which had previously filed a proof of claim in the Chapter XI proceedings for payment of the taxes, now asked the bankruptcy court to pay the amount of withheld taxes prior to the payment of the costs and expenses of administration of the bankruptcy proceed-

ings. The referee denied the request. The District Court agreed with the referee. The Court of Appeals affirmed the order denying payment, 419 F. 2d 1068. The case is here on petition for a writ of certiorari which we granted (400 U. S. 817) because of a conflict among the circuits, cf. *New York* v. *Rassner*, 127 F. 2d 703, *United States* v. *Sampsell*, 193 F. 2d 154; *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938.

The United States relies for its priority on 26 U. S. C. § 7501 (a), which provides:

> "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose."

The argument is that withheld taxes are a trust in favor of the United States. It is answered that the debtor in possession failed to segregate the taxes so withheld; hence there was no trust. To that the United States replies that since the debtor-in-possession was a court-appointed officer, the misconduct of the officer should not defeat the trust.[1] And, the argument continues, creditors are not unfairly harmed since the trust funds were never an asset of the estate.

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[1] "Where the funds are received by a public officer, such as a receiver or trustee in bankruptcy, the owner of the funds is entitled to priority with respect to the funds so received without further tracing." Scott on Trusts, § 521, Vol. V, p. 3652.

We deal, however, with a Bankruptcy Act which we conclude is an overriding statement of federal policy on this question of priorities. Section 64 (a)(1) of the Act, 11 U. S. C. § 104 (a)(1) provides:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration . . . . Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding . . . shall have priority in advance of payment of the unpaid costs and expenses of administration . . . incurred in the superseded proceeding. . . ."

Until 1926 claims for administrative expenses were subordinate to tax claims.[2] In that year they were placed ahead of taxes.[3] The costs and administrative expenses of a trustee were, however, still subordinate to claims of the referee or creditors for preserving or recovering assets.[4] In 1952 the Act was amended to give priority to administrative expenses of an ensuing bankruptcy proceeding over unpaid administrative expenses of a superseded proceeding.[5]

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[2] 3A Collier on Bankruptcy, 2046–2048, 2155–2156.

[3] 44 Stat. 662.

[4] Collier, *supra* n. 2, 2049, 2050, n. 15.

[5] 66 Stat. 426. "Unless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceeding, ahead of all prior incurred and unpaid administration costs and expenses, there is always danger of a breakdown of administration. There should be assurance to the trustee in the ensuing proceeding that the costs and expenses incurred by him, such as bond and insurance pre-

We have then a progressive legislative development that (1) marks a decline in the grant of a tax preference to the United States and (2) marks an ascending priority for costs and expenses of administration.

We think the statutory policy of subordinating taxes to costs and expenses of administration would not be served by creating or enforcing trusts which eat up an estate, leaving little or nothing for creditors and court officers whose goods and services created the assets. In *Nicholas* v. *United States*, 384 U. S. 678, 690–692, we rejected the claim of the United States that under § 7501 (a) it was entitled to interest accruing after the arrangement under Chapter XI and during the bankruptcy. We so held because to allow interest would run counter to the "strong policy of § 64 (a)(1) of the Bankruptcy Act." *Id.*, 691. To allow the present claimed priority for the principal would by the same token run counter to the grain of the Bankruptcy Act.

This construction conforms with a literal reading of the second sentence of § 7501 (a) which makes the amount of such fund "payable in the same manner and subject to the same provisions and limitations . . . as are applicable with respect to the taxes from which such fund arose." In conformity with *Nicholas* we read those words against the history of the Bankruptcy Act. So read the fund is as subordinate as the taxes. See *In re Green*, 264 F. Supp. 849, 851.

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miums, costs of conducting a public sale and compensation for his services and for the services of his attorney, will be paid out of the assets liquidated and administered by him ahead of the prior unpaid costs and expenses." S. Rep. No. 1395, 82d Cong., 2d Sess., p. 5.

In 1966 Congress amended § 17 of the Act so as to make dischargeable all taxes due and owing more than three years prior to bankruptcy except, *inter alia*, those withheld or collected from others but not paid over. Act of July 5, 1966, 80 Stat. 270.

What we decide today is also in accord with those decisions which hold that the specific priorities granted by Congress in the Bankruptcy Act govern generalized statutes giving the United States priority in a wide range of situations.[6] *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152; *Davis* v. *Pringle*, 268 U. S. 315.

Affirmed.

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[6] The competing Act in those cases was § 3466 Rev. Stat., which read: "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

SUPREME COURT OF THE UNITED STATES

No. 125.—October Term, 1970

United States, Petitioner, *v.* William L. Randall, Trustee.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[March 24, 1971]

Mr. Justice Blackmun, whom The Chief Justice, Mr. Justice Black, and Mr. Justice Stewart join, dissenting.

I cannot escape the conviction that the Court's ruling on this very narrow issue dishonors property of the United States and effects a windfall for those who benefit from the ruling.

The amount in issue consists of income and FICA taxes actually withheld from wages of employees. These are not taxes of the debtor. Were it not for the withholding scheme, the amounts would have been paid out to the employees as gross wages and it would have been their obligation, as it was prior to the adoption of withholding, to pay those taxes. Instead, the employer now withholds, and § 7501 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 7501 (a), appropriately impresses a trust upon the amounts withheld. The Court today defeats the trust only because the arrangement debtor in possession, a corporation which the Court has characterized as "an officer of the bankruptcy court," *Nicholas* v. *United States*, 384 U. S. 678, 690 (1966), flagrantly disobeyed the arrangement court's specific order to pay the withholding amounts into a separate bank account. The respondent trustee concedes that if the order had been obeyed, the trustee would have no case. Transcript of Oral Argument, p. 34.

The decision in *Nicholas* does not demand the result reached by the Court. That case concerned interest accruing during bankruptcy, not the tax on which the interest was asserted. The present decision is a long step down the road beyond *Nicholas*.

Neither am I persuaded by the suggestion made by the trustee, and seemingly reflected in the Court's opinion, that a contrary decision would leave little or nothing for administrative costs of the bankruptcy proceeding and therefore would deter orderly administration of bankrupt estates. I suspect that the fact of bankruptcy administration of a vast number of small or no asset cases is a sufficient refutation of that suggestion.

I find myself in accord with the views expressed by the Second, Sixth, and Ninth Circuits. *City of New York* v. *Rassner*, 127 F. 2d 703 (CA2 1942); *In re Airline-Arista Printing Corp.*, 267 F. 2d 333 (CA2 1959), affirming 156 F. Supp. 403 (SDNY 1958); *Hercules Service Parts Co.* v. *United States*, 202 F. 2d 938 (CA6 1953); *United States* v. *Sampsell*, 193 F. 2d 154 (CA9 1951). I would reverse.